Equity Stock Selection Process

Concepts of Fundamental Analysis

Agenda

In this session, you will learn about:

- Equity Shares
- Preference Shares
- Depository Receipts and its Types
- IPO Process
- Equities as an Asset Class
- Stock Evaluation
- Fundamental Analysis
- Qualitative Factors - The Company
- Quantitative Factors
- Corporate Actions

Equity (Ordinary) Shares

What is Equity?

Equity

Equity is also known as Common Stock or Ordinary share capital.

Equity is nothing but ownership in a business.

Equity represents a part of the total share capital of a company.

Company can issue two types of shares: Preference and Equity.

Raising capital by issue of shares is a most important method of raising long-term funds.

Those funds can be invested in permanent assets like land , building, plant and machinery, furniture etc.

E.g.: If you hold 10 shares of XYZ Company out of total 1000 shares floated by the company – you are 1% owner in XYZ's business.

Equity, Stock, Shares

Stock is a share in the ownership of a company. Stock represents a claim on the company's assets and earnings.

Whether you say shares, equity, or stock, it all means the same thing!

As you acquire more stock, your ownership stake in the company becomes greater.

Equity

Equity are ordinary shares or stock in the ownership of a company.

Mr. A is 30% owner of XYZ Ltd.

XYZ Ltd.
1000 floated shares

Mr. A
300 shares

IMPORTANCE

Raising capital by issue of shares is a most important method of raising long-term funds.

EQUITY

- PREFERENCE SHARE
- EQUITY SHARE

Facts on Stocks and Shares

1. Owning a stock or a share means you are a partial owner of the company, and you get voting rights in certain company issues.

2. Investments in stocks can generate returns through dividends.

3. Stocks offer no guarantee of any returns and can lose value, even in the long run.

4. Over the long run, stocks have historically averaged about 10% annual returns.

5. Primarily invested to earn Capital Appreciation and Dividends

Features of Equity Shares

OWNED CAPITAL	Shareholders are the owners of the business.
RETURN ON SHARES	Returns are paid out of profits in the form of dividends and in form of Capital Appreciation
TRANSFER OF SHARES	They can be freely bought and sold.
BENEFIT OF RIGHTS ISSUE	Issue of additional stock of the company at a discount due to loyalty and goodwill.
Equal Rights	Every shareholder is considered 'equal' in the eyes of the company in terms of voting or receiving dividends

Advantages of Equity Shares

So, what do you gain by investing in equity shares?

DIVIDEND	Received in form of Cash & Stock Dividends
CAPITAL GAIN	Capital appreciation in case the company performs well.
LIMITED LIABILITY	Liability is limited to the number of the shares held.
OWNERSHIP RIGHTS	Owner of the company.
RIGHTS ISSUE	Gives you an option to purchase additional shares of the company at a discounted price
BONUS SHARES	A company will declare bonus shares to every shareholder. Consider this to be a free form of income

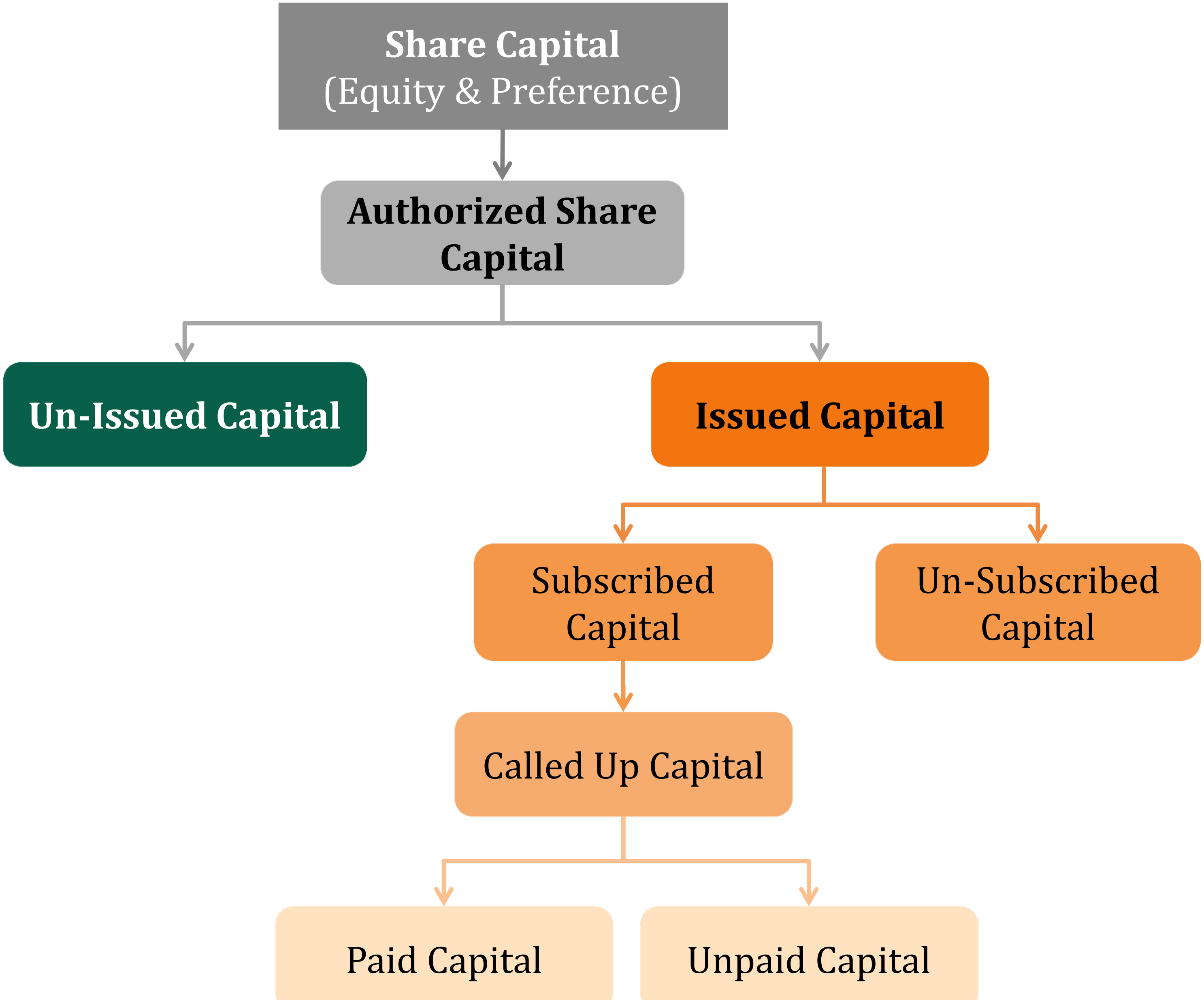
Disadvantages of Equity Share Investment

What could you possibly lose by investing in equity shares?

DIVIDEND	Dividends are not mandatory to be provided by the company.
FLUCTUATING PRICE	Fluctuations in market may lead to capital depreciation.
LIMITED CONTROL	Control on the company is limited to the amount of stock holding.

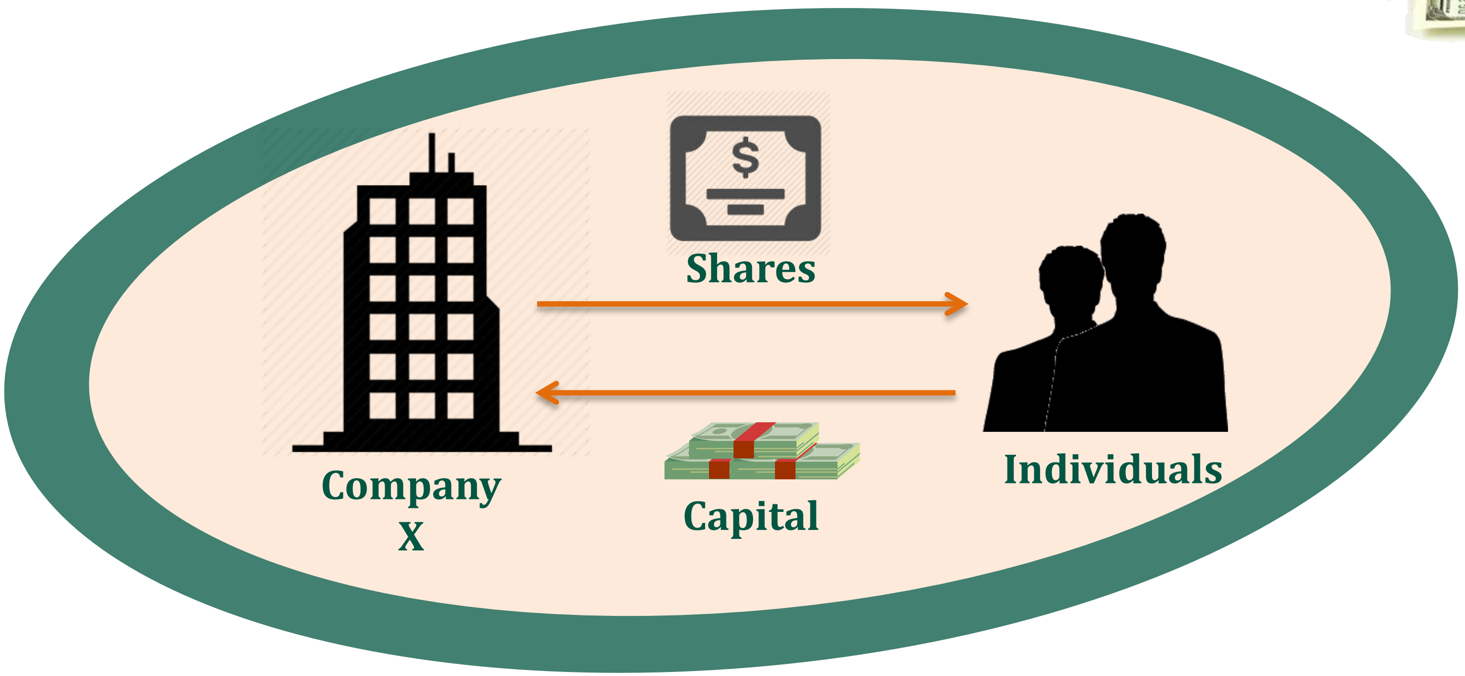
Microsoft (MSFT) issued its first dividend 17 years after going public!!

Types of Share Capital

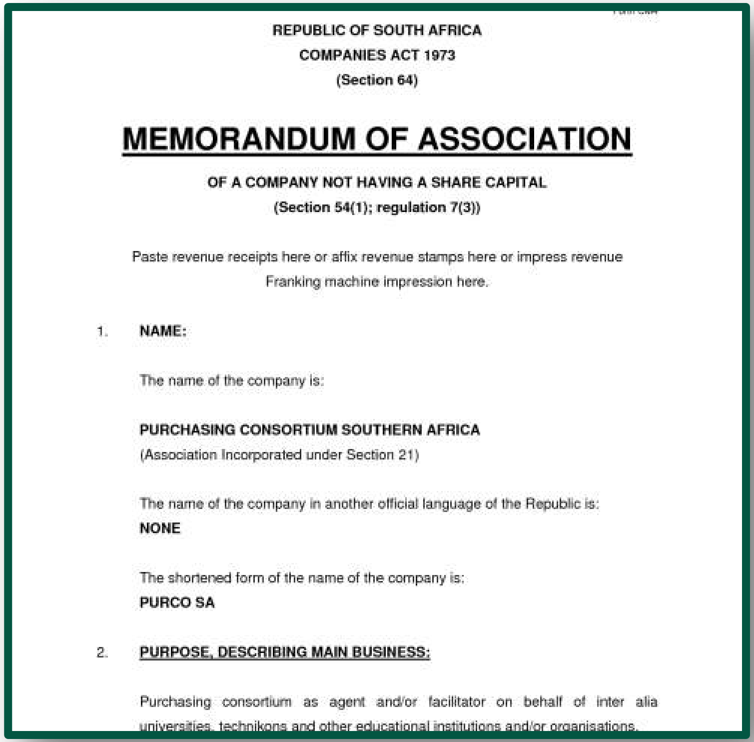


Authorized Share Capital

Authorized capital is the **maximum amount of capital** which a company can raise by selling its shares.



Authorized Share Capital



REPUBLIC OF SOUTH AFRICA
COMPANIES ACT 1973
(Section 64)

MEMORANDUM OF ASSOCIATION

OF A COMPANY NOT HAVING A SHARE CAPITAL
(Section 54(1); regulation 7(3))

Paste revenue receipts here or affix revenue stamps here or impress revenue
Franking machine impression here.

1. **NAME:**

The name of the company is:

PURCHASING CONSORTIUM SOUTHERN AFRICA
(Association Incorporated under Section 21)

The name of the company in another official language of the Republic is:
NONE

The shortened form of the name of the company is:
PURCO SA

2. **PURPOSE, DESCRIBING MAIN BUSINESS:**

Purchasing consortium as agent and/or facilitator on behalf of inter alia universities, technikons and other educational institutions and/or organisations.

The sum mentioned in the Capital clause of Memorandum of Association of a company.

The company is registered with this amount.

This limit cannot be exceeded unless the Memorandum of Association is changed.

Calculation of Authorized Share Capital

FORMULA

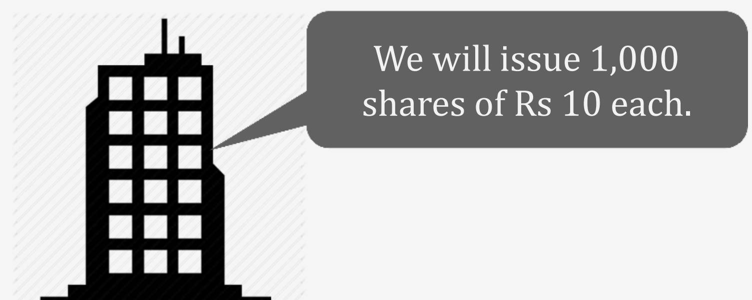
Authorized Share Capital =

Number of Permitted Shares X **Par Value**

- Par Value refers to the stock value as stated in the Company Charter.
- This is also known as **Face Value**.

PAR VALUE

Example



Authorized Share Capital: Rs. 10,000

Authorized Capital

Why Retain shares?

- To retain a controlling interest in the company.
- To leave room for future issuance of additional stock.

Authorized share capital is also referred to, at times, as registered capital.

FORMULA

Authorized Capital = Shares Issued + Shares Unissued

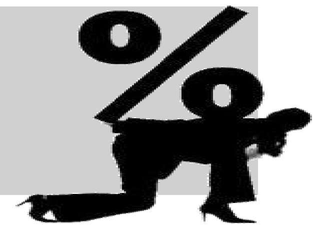
Issued Share Capital

The amount of capital out of the authorized capital which has been issued by the company to the subscribers.

FORMULA

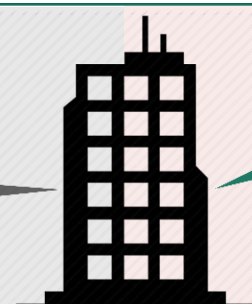
Issued Share Capital =

Number of Shares Actually Issued **x** Par Value



Example

We will issue 1,000 shares of Rs 10 each.



We will issue only 300 shares of Rs 10 each.

Authorised Share Capital: Rs. 10,000	Issued Share Capital: Rs. 3,000

NOTE

Authorized Share Capital $\geq$ Issued Capital

Issued Capital

Issued Capital is the total of the share capital issued (allocated) to shareholders.

FORMULA

AUTHORISED CAPITAL $\geq$ SHARE CAPITAL ISSUED

ISSUED SHARES = OUTSTANDING SHARES + TREASURY SHARES

It is that amount which the boards of directors and/or shareholders have agreed to allocate

Shares outstanding are those issued shares which are held by the investors in the company.

Subscribed, Called-up & Paid-up Capital

SUBSCRIBED CAPITAL	CALLED-UP CAPITAL	PAID-UP CAPITAL
The amount of capital for which company has received applications from the interested general public	The total amount of issued capital that the shareholders are required to pay.	The amount of share capital paid by the shareholders.

Note SUBSCRIBED CAPITAL $\geq$ CALLED-UP CAPITAL $\geq$ PAID-UP CAPITAL

Example

ABC Ltd was registered with registrar with a registered capital of Rs. 20,000,000 where each share is of Rs. 10.

Applications have been received for 1,000,000 shares.

Company actually issued only 600,000 shares where company has called for Rs. 8 per share.

All the calls have been met in full except three shareholders who still owe for their 6000 shares in total.

Can you calculate the five different types of share capital you just learnt about?

1. Authorized capital = Rs. 2,00,00,000
2. Subscribed capital = 1,000,000 x Rs. 10 = Rs. 1,00,00,000
3. Issued capital = 600,000 x Rs.10 = Rs. 60,00,000
4. Called-up capital = 600,000 x Rs. 8 = Rs. 48,00,000
5. Paid-up capital = 4,800,000 – (6000 x Rs. 8) = Rs. 47,52,000

Share Capital

It refers to the portion of a company's equity that has been obtained (or will be obtained) by trading stock to a shareholder for cash or an equivalent item of capital value.

It is also used to describe the number and types of shares that compose a company's share structure.

If the allocation price of shares is greater than their par value,
the shares are said to be at a premium.

Authorized Capital

Issued Capital

Types of Share Capital – Authorized Capital

- The number of stock units that a publicly traded company can issue as stated in its Articles of Association (AOA)
- Authorized share capital is often not fully used by management in order to leave room for future issuance of additional stock in case the company needs to raise capital quickly.
- Another reason to keep shares, is to retain a controlling interest in the company.
- Authorized share capital is also referred to, at times, as registered capital. It presents the upper boundary for the actually issued share capital.

FORMULA

Shares Authorized = Shares Issued + Shares Unissued

Market Capitalization

The total value of the company or market in terms of the outstanding shares
Is calculated by multiplying the shares by the current market price.
Also known as Market Cap (MC)

Market Capitalization

- Large Cap
  MC > $10 bn
- Mid Cap
  MC $2-10 bn
- SmallCap
  MC < $2 bn

Example

If a company has 15million shares outstanding,
and its current market price is Rs 20,
then its market capitalization is Rs. 300million

Preference Shares

What are Preference Shares?

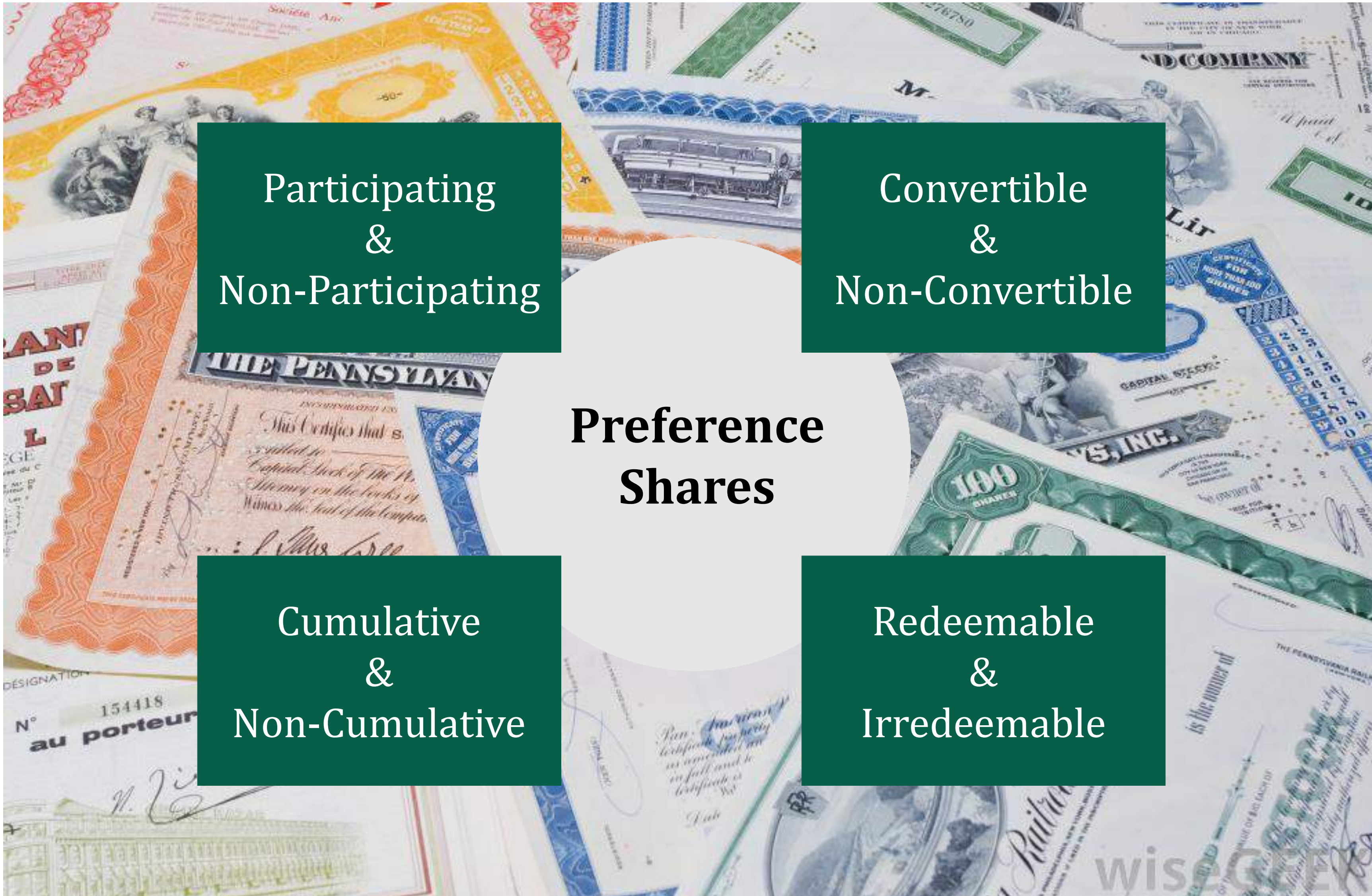
Preference shares are those shares which carry preferential rights with regards to the payment of dividend and on repayment of capital in case of winding up of the company.

DIVIDEND:

The rate of dividend on these shares is fixed and the dividend on these shares must be paid before any dividend is paid to ordinary shares.

Directors, however, may decide not to pay any dividend to any class of shareholders even if there are sufficient profits. But, if any how, they decide to pay the dividend, preference shareholders will get the priority to pay the ordinary shareholders.

Types of Preference Shares



Types of Preference Shares(Contd.)

Cumulative

Dividends are not paid in the years the company makes a loss.

Missed dividends are accumulated and paid together in the year the company makes a profit.

Non-Cumulative

Non–Cumulative preference shares do not get accumulated dividends.

All missed dividends are not paid. They receive dividends for the profit making year only.

Types of Preference Shares(Contd.)

Redeemable	Non-Redeemable
Shares which are redeemed at a future date.	Irredeemable preference shares are not redeemed by the issuing company.
The price is also pre-agreed in rare cases.	They are only paid back when company is liquidated.
Usually redeemed after 20 years.	

Types of Preference Shares(Contd.)

Convertible	Non-Convertible
Converted into a number of shares of the company's common stock after a predetermined time span.	Non-convertible preference shares cannot be converted to common shares.
The two factors used are the conversion ratio and conversion price.	They remain as Preference shares during their whole life.

Types of Preference Shares(Contd.)

Participating	**Non-Participating**
Shareholder can participate in the surplus profits of the organization	Receive a fixed dividend
Sometimes, they are also paid the extra dividend which is paid to the Equity shareholders.	Do not participate in any surplus dividends

Advantages of Preference Shares

PREFERENTIAL RIGHT

They have preferential rights over common shares in the event of dividend payment and liquidation.

FIXED INCOME

They receive fixed dividends.

VOTING RIGHTS

They can vote in matters concerning their own interest.

Disadvantages of Preference Shares

NO VOTING RIGHTS

They can only vote in matters concerning their own interest and not otherwise.

FIXED INCOME

Since dividend is fixed they may receive fewer dividends if the company issues higher dividend to common stockholders.

NO CLAIM OVER SURPLUS

Dividend being fixed they cannot take advantage of surplus profits except in the case of participating preference shareholders.

NO GUARANTEE OVER ASSETS

Their ownership does not guarantee ownership over any assets of the company.

Difference - Equity and Preference Shares

Equity Shares	Preference Shares
Dividend on equity shares are paid after dividend preference shares are paid.	Preference shares are paid dividend before equity shares.
Rate of dividend is decided by the Board of Directors.	Rate of dividend is fixed at the time of the issue.
Equity shares cannot be converted to preference shares.	Convertible preference shares can be converted into equity shares.

Difference - Equity and Preference Shares

Equity Shares	Preference Shares
Equity shareholders have voting rights.	Preference shareholders do not have voting rights except for matters concerning their interest.
At the time of winding up, equity shareholders are paid after preference shareholders.	At the time of winding up, preference shareholders are paid before equity shareholders.

Priority for Profit Distribution

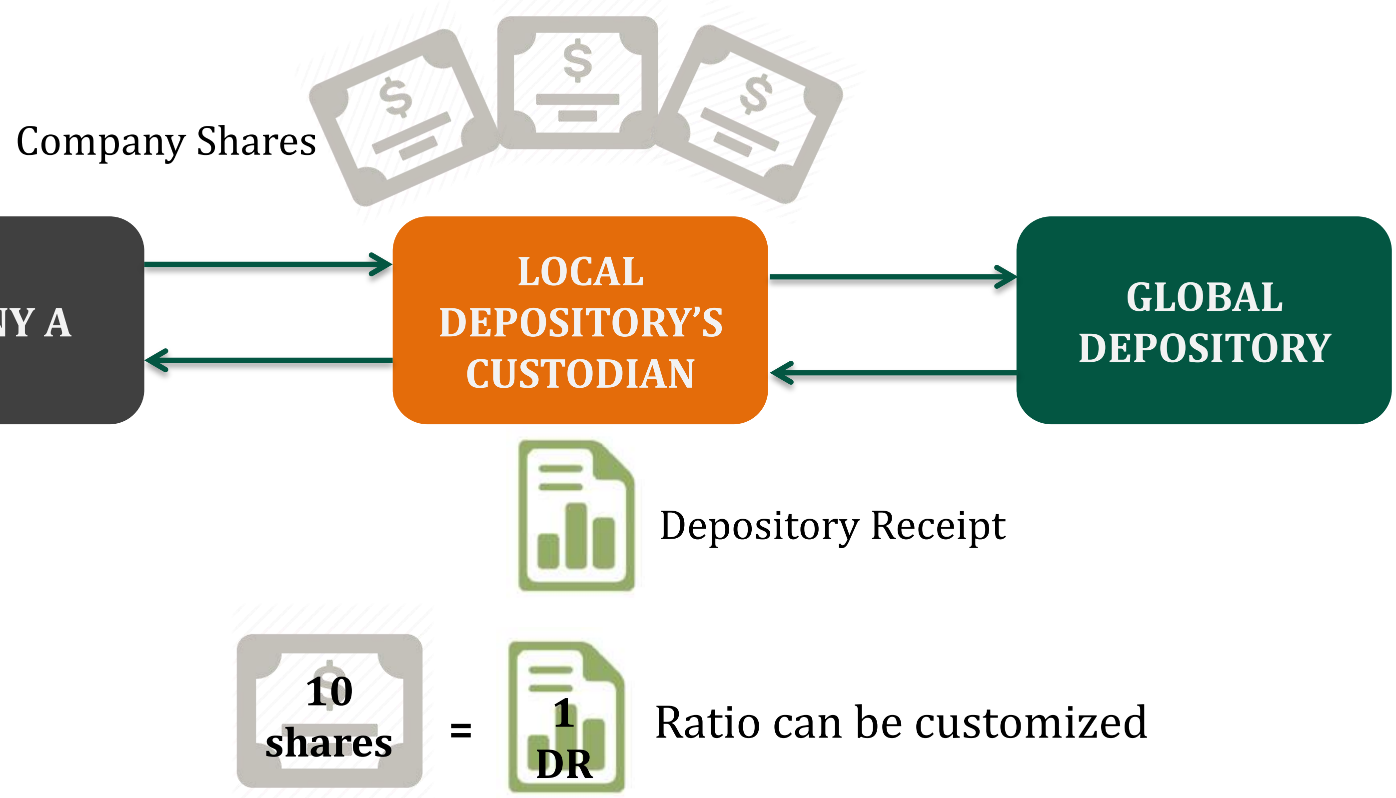
Given that a company has decided to make available an amount for distribution, this is the order in which the funds are allocated:

1. Cumulative Preferred Stock
2. Non-Cumulative Preferred Stock
3. Common Stock

Depository Receipts (DRs)

What is a Depository Receipt?

A Depository Receipt (DR) is a negotiable certificate that represents a company's publicly traded debt or equity.



DRs are created when a company's shares are delivered to a local depository's custodian, which instructs its global depository to issue the DRs.

Types of Depository Receipts

American Depository Receipt (ADRs)

Global Depository Receipt (GDRs)

Indian Depository Receipt (IDRs)

TYPES OF DEPOSITORY RECEIPTS

American Depositary Receipts (ADRs)

American Depository Receipts (ADRs)

ADRs represent shares of non-US companies and trade on American Stock Exchanges.

ADRs are traded just like US stocks on the US Stock Exchange

PRICES IN US DOLLAR

DIVIDENDS IN US DOLLAR

They carry voting rights as the DR's are representative of the underlying company's shares.

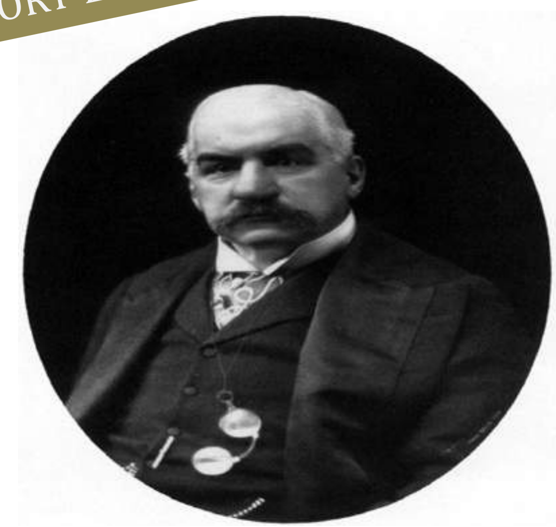
The prices of the ADR usually track the underlyer's prices in the domestic market.

American Depository Receipts (ADRs)

DID YOU KNOW?

AMERICAN DEPOSITORY RECEIPTS MAKE UP OVER 50% OF THE DEPOSITORY RECEIPTS ISSUED GLOBALLY

HISTORY LESSON



ADRs have been introduced to the financial markets as early as **April 29, 1927**, when the investment bank **J. P. Morgan** launched the first-ever ADR.

Workflow of an ADR

A Russian gas company wants to get its shares traded in America via an ADR.

↓

The Russian company approaches a depository in US which can facilitate the issuance

↓

The depository will get in touch with local custodian who will collect the shares from the company.

↓

Once the shares are acquired by the local custodian, the depository will issue ADRs to local investors in US which will be a receipt.

Workflow of an ADR

WHAT WILL BE THE VALUE OF THE ADR?

THE PRICE OF THE RUSSIAN GAS COMPANY IS AT **RUB 150.**

EACH DR CONSISTS OF **10 SHARES**.

THE CURRENT USD/RUB EXCHANGE RATE IS: **60**

The Value of each ADR will be:

(10*150) /60

= $ 25

Types of American Depository Receipts

There are two types of ADRs:

SPONSORED ADRs

UNSPONSORED ADRs

DID YOU KNOW?

Approximately half of all ADR programs in existence today are unsponsored.

Sponsored ADRs

An American Depository Receipt (ADR) issued by a depository/custodian on behalf of the foreign company whose equity serves as the underlying asset.

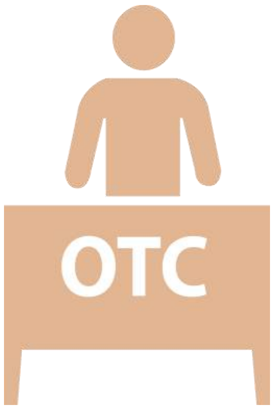
Listed on major US exchanges

Legal relationship between the ADR and the foreign company

Tap into the capital markets of the US

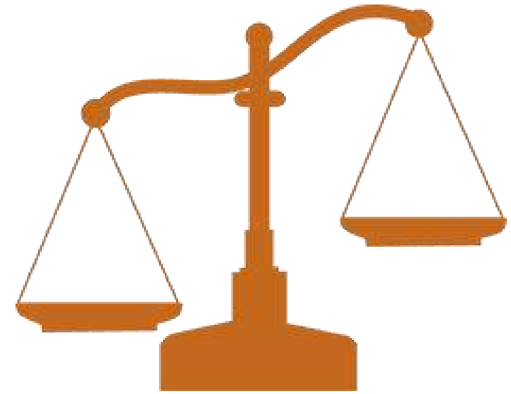
Obtain returns from higher growth of emerging markets

Unsponsored ADRs



Trade on the OTC market

Without consent of underlying company



Issued in accordance with market demand

Issued by more than one Depository Bank

Services only the ADRs it has issued

No voting rights

Advantages of American Depositary Receipt

Diversification	It enables an American investor to invest in a Non-American company and diversify his portfolio without the hassle of geographical or currency restrictions.
Liquidity	As it is on stock exchanges.
Allows raising of Capital	It allows a company to raise capital in the USA, while making itself more well-known in their markets.

Disadvantages of American Depositary Receipt

High Fee	Receipts are subject to high fees while buying and selling.
Lack Of Information	Only the positive image of the company is usually portrayed by the depository to the potential investors
Forex Risk	The value of the ADR and the dividends issued by the underlyer company are exposed to changes in the FX rates

Examples of ADR's by Indian Companies

MTNL

DR. REDDY'S

WIPRO Applying Thought

rediff.com

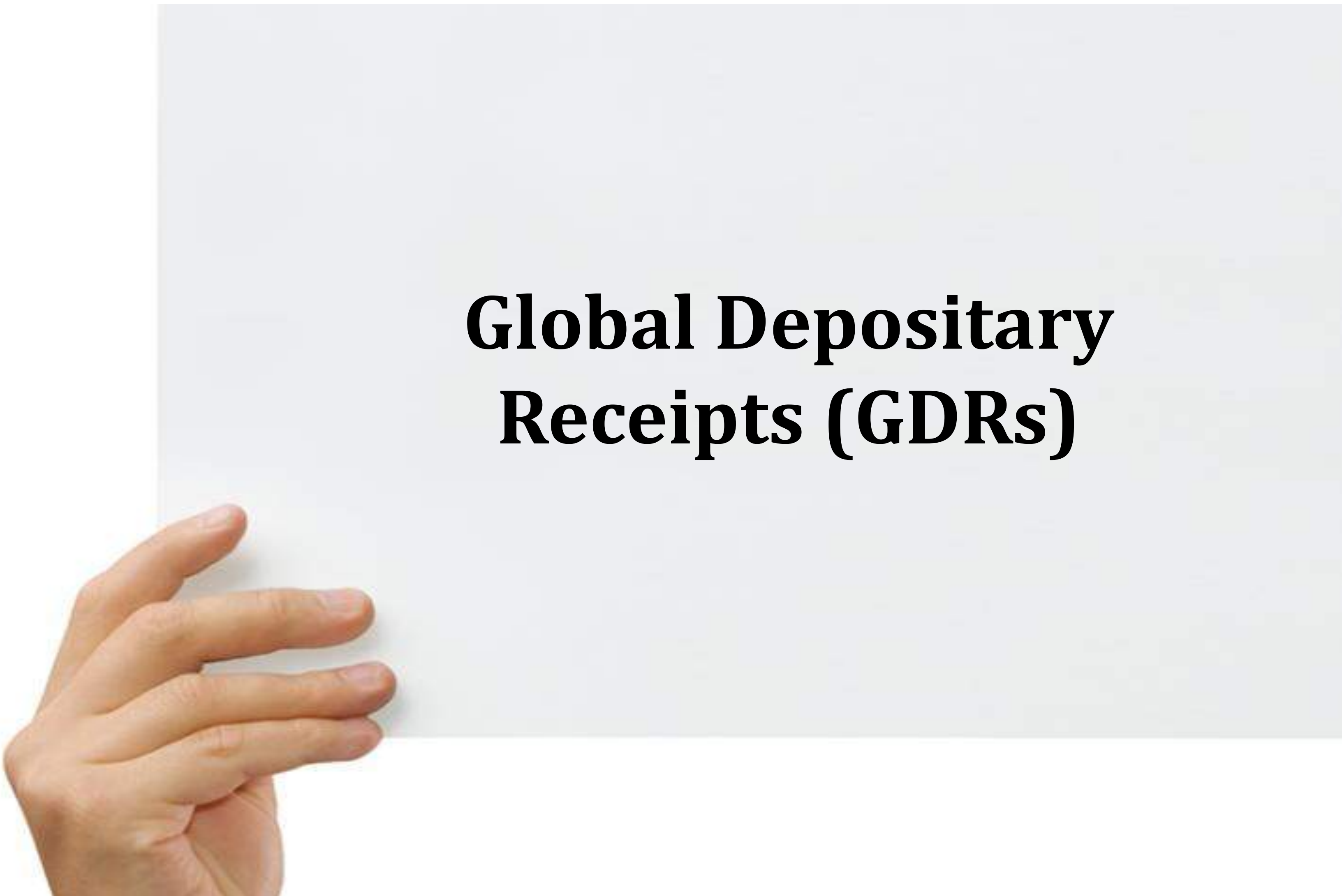
ICICI Bank

TATA MOTORS

Infosys®

Sify

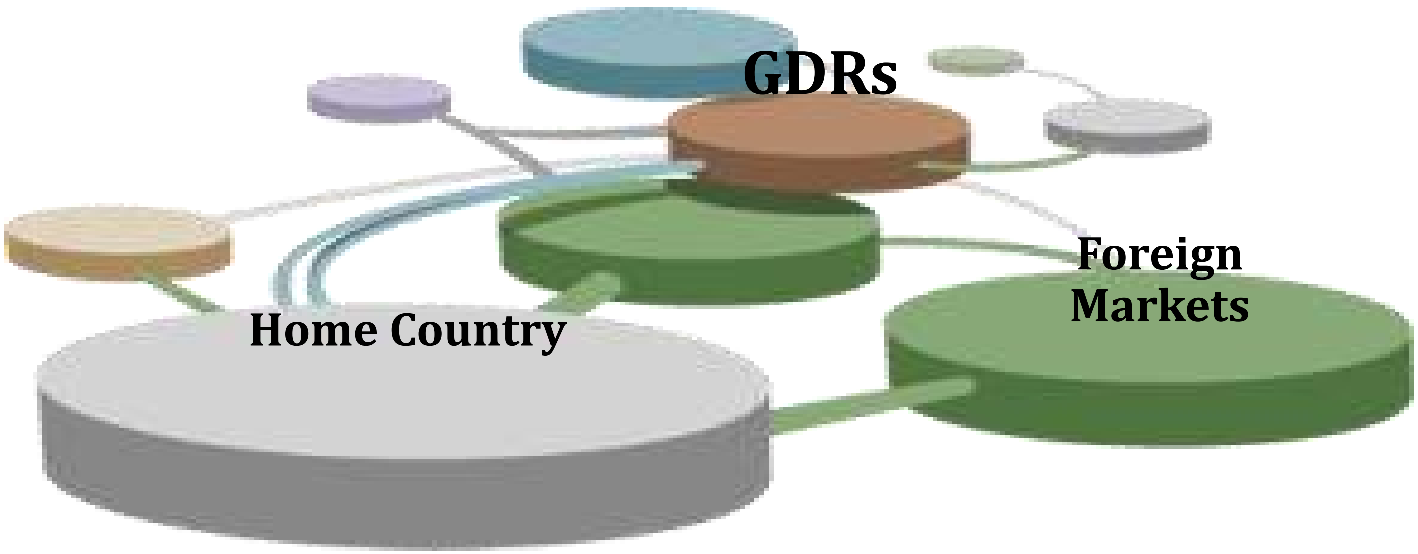
HDFC BANK



Global Depositary Receipts (GDRs)

Global Depository Receipts

Global Depository Receipts (GDR) are receipts which represents ownership of a foreign-based corporation stock shares which are traded in numerous capital markets around the world.



To raise money in more than one market, some corporations use global depositary receipts (GDRs) to sell their stock on markets in countries other than the one where they have their headquarters.

Advantages of Global Depository Receipt

DIVERSIFICATION

It enables an investor to invest in a Non-Domestic company and diversify his portfolio

INCREASING GLOBAL TRADE

- Increase not only volumes on local and foreign markets
- Exchange of information, technology, regulatory procedures, and market transparency.

Disadvantages of Global Depositary Receipt

Forex risk while paying dividends	Dividends are paid in a foreign currency which is then subject to volatility in the forex market.
Cannot be split	A GDR represents a number of shares in one receipt and so cannot be traded in parts.
Beneficial for HNI	Due to the high investment in buying a GDR, it is a good tool for only HNI investors.

Examples of GDRs Traded on Stock Exchanges

IMARTICUS LEARNING

Company		Stock Exchange
ITC	Trading →	Luxembourg Stock Exchange
GAZPROM		SGX SINGAPORE EXCHANGE
ROMGAZ		London Stock Exchange

Difference Between ADR and GDR

ADR	GDR
ADR is only negotiable in US.	GDR is negotiable globally.
Deals with single currency i.e. USD.	Deals with multiple currencies.
Traded over the New York Stock Exchange (NYSE), NASDAQ.	Traded on the London Stock Exchange, Luxemburg Stock Exchange and Frankfurt Stock Exchange.
Cost is higher and legal liability is more.	Cost is comparatively less than ADR and liability is less.

Indian Depositary Receipts (IDRs)

Indian Depository Receipts

Indian Depository Receipts (IDRs) are financial instruments that allow foreign companies to mobilize funds from the Indian capital markets.

DENOMINATION:

Indian Rupees

CREATED BY:

Domestic (Indian) Depository

CREATED AGAINST:

Underlying equity shares of issuing company

GOAL:

To enable foreign companies to raise funds from the Indian Securities Markets.

DID YOU KNOW?

Standard Chartered Bank's IDR on 25th May, 2010 was the first ever IDR issue in the history of Indian Capital Markets.

What is a Stock Exchange?

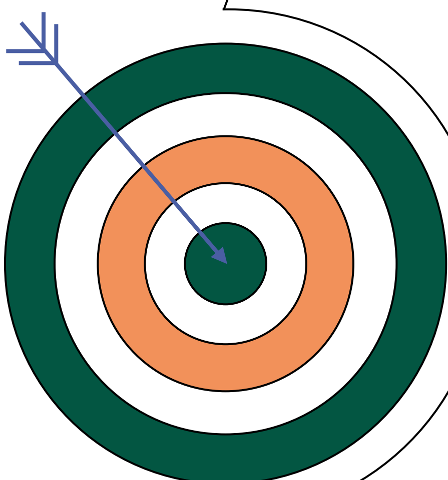
A stock exchange is an institution, organization or association that serves as a market for trading financial instruments such as equity shares, bonds and/ or derivatives.

Exchanges make money in several different areas.

Listings, sales, and selling market statistics are some of the various ways that they produce revenue.

Most modern stock exchanges, have both a trading floor and an electronic trading system.

Rationale of Secondary Market



- The secondary market is the financial market for trading of securities that have already been issued in a public offering.
- Once a newly issued stock is listed on a stock exchange, investors and speculators can easily trade on the exchange, as market makers provide bids and offers in the new stock.
- Securities are sold by and transferred from one investor or speculator to another.
- It is the only way to create this liquidity for investors and speculators to meet at a fixed place regularly.

Major Stock Exchanges in the World

New York Stock Exchange – NYSE:

- Headquartered in New York City is the largest stock exchange in the world by both market capitalization and trade value.
- NYSE is the premier listing venue for the world's leading large- and medium-sized companies. Operated by NYSE Euronext, the holding company created by the combination of NYSE Group, Inc. and Euronext.
- NYSE offers a broad and growing array of financial products and services in cash equities, futures, options, exchange-traded products (ETPs), bonds, market data, and commercial technology solutions.

Featuring more than 8000 listed issues it includes 90% of the Dow Jones Industrial Average and 82% of the S&P 500 stock market indexes volume.

Major Stock Exchanges in the World(Contd.)

NASDAQ: National Association of Securities Dealers Automated Quotations

Major Stock Exchanges in the World(Contd.)

IMARTICUS LEARNING

NASDAQ:

- Headquartered in New York City.
- It is the second largest stock exchange in the world by market capitalization and trade value.
- The exchange is owned by NASDAQ OMX Group which also owns and operates 24 markets, 3 clearinghouses and 5 central securities depositories supporting equities, options, fixed income, derivatives, commodities, futures and structured products.

It is a home to approximately 3,400 listed companies and its main index is the NASDAQ Composite, which has been published since its inception.

Major Stock Exchanges in the World(Contd.)

London Stock Exchange

OLDEST STOCK EXCHANGE
IN THE WORLD

Major Stock Exchanges in the World(Contd.)

London Stock Exchange – LSE:

- Headquartered in London, LSE is the fourth-largest stock exchange in the world.
- The London Stock Exchange runs several markets for listing, giving an opportunity for different sized companies to list.
- For the biggest companies exists the Premium Listed Main Market, while in terms of smaller SME's the Stock Exchange operates the Alternative Investment Market and for international companies that fall outside the EU, it operates the Depository Receipt scheme as a way of listing and raising capital.

It is the most international of all the world's stock exchanges, with around 3,000 companies from over 70 countries admitted to trading on its markets


Equities as an Asset Class

Equity Shares

An equity investment generally refers to the buying and holding of shares of stock on a stock market by individuals and firms in anticipation of income from dividends and capital gains, as the value of the stock rises.

Equity Investor

Anticipates Returns

Dividends

Capital Appreciation

Case Study – Wipro

Year 2015 -

Dividend Declared – Rs.12/-
Share Price – Rs. 552.75/-
Dividend Yield – Rs. 2.17%

Year 2014 -

Dividend Declared – Rs.8/-
Average Share Price – Rs.508/-
Dividend Yield – 1.57%

Year 2013 -

Dividend Declared – Rs.7/-
Average Share Price – Rs. 383/-
Dividend Yield – 1.82 %

Year 2012 -

Dividend Declared – Rs.6/-
Average Share Price – Rs.424/-
Dividend Yield – Rs.1.41%

Year 2011 -

Dividend Declared – Rs.6/-
Average Share Price – Rs. 445/-
Dividend Yield – 1.34%

Capital Appreciation – Wipro Shares Since 1980

Suppose You Bought Wipro shares for Rs.10000 (100 share value Rs. 100) in 1980-

Bonus & Stock Split History

- 1981, 1:1 Bonus =200 shares
- 1985, 1:1 Bonus =400 shares
- **1986 split to Rs 10 =4000 shares**
- 1987, 1 :1 Bonus =8000
- 1989, 1:1 Bonus =16000
- 1992, 1:1 Bonus =32000
- 1995, 1:1 Bonus =64000
- 1997, 2:1 Bonus =1,92,000
- **1999 Split to Rs 2 =9,60,000**
- 2004, 2:1 Bonus =28,80,000
- 2005, 1:1 Bonus =57,60,000
- 2010, 3:2 Bonus =96,00,000

Today's Rate Rs 553/-

Current Market Valuation of the Investment – 530.88 Cr

Comparison with Other Asset Classes

Price of an Apartment in 1980:

Rs. 2 Lacs - Current Value – Rs. 3 Cr.

Rs. 10,000 invested in FD at an annual Interest Rate of 10% in 1980:

Current Value – Rs. 2,81,024

Equity : Negative Side

DLF India

IPO Price – Rs. 525/- (July 2007)
Markey Cap at the time of IPO – Rs. 89551 Cr
Current Market Price – Rs. 117
Current Market Capitalization – Rs. 5209 Cr

Reliance Communication

Price in Jan 2008 – Rs. 804/-
Market Cap in Jan 2008 – Rs. 165917 Cr
Current Market Price – Rs. 67.85
Current Market Cap – Rs. 6730 Cr

Suzlon

Price in Jan 2008 – Rs. 464/-
Market Cap in Jan 2008 – Rs. 68066 Cr
Current Market Price – Rs. 23
Current Market Cap – Rs. 4214 Cr

Equity : Negative Side

Examples that are mentioned earlier, show that equity as an asset class can be a value creator and value destructor.

It is very important to understand the dynamics which can affect the capital appreciation of a share.

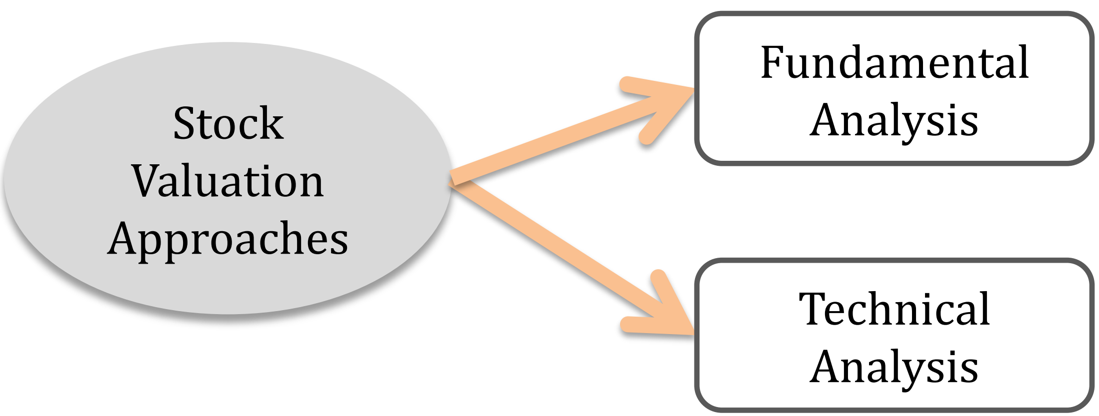
Though dividends can provide some regular cash flows, but it is not the reason why investors invest in shares.

Equity evaluation is a process with which you form an informed view on the future prospects of an equity share of a company.

Stock Evaluation

The main objective of stock valuation is to understand whether a particular stock is over valued or undervalued.

The expectation is, undervalued stocks will, on the whole, rise in value, while overvalued stocks will, on the whole, fall.



Fundamental Analysis

Fundamental Analysis

Stock valuation based on fundamentals aims to give an estimate of the intrinsic value of a stock.

Intrinsic value is a value that an investor can compare with security’s current price.

Fundamental analysts attempt to study everything that can affect the security's value, like Macroeconomic factors and company-specific factors.

Fundamental Analysis Rely on future cash flows and profitability of the business.

Fundamental Analysis

- Fundamental Analyst tries to answer the following questions:
  - Is the company's revenue growing?
  - Is it actually making a profit?
  - Is it in a strong-enough position to beat out its competitors in the future?
  - Is the company's business model robust enough?
  - Is it able to repay its debts?
  - Is the management good enough to run the business?
  - Is management trying to window dress the financials?
  - Is the macro economic factors and policy developments are favourable for the company?

Fundamental Analysis

Fundamentals are anything which determines the well being of the company and Fundamental analysts tries answer both:

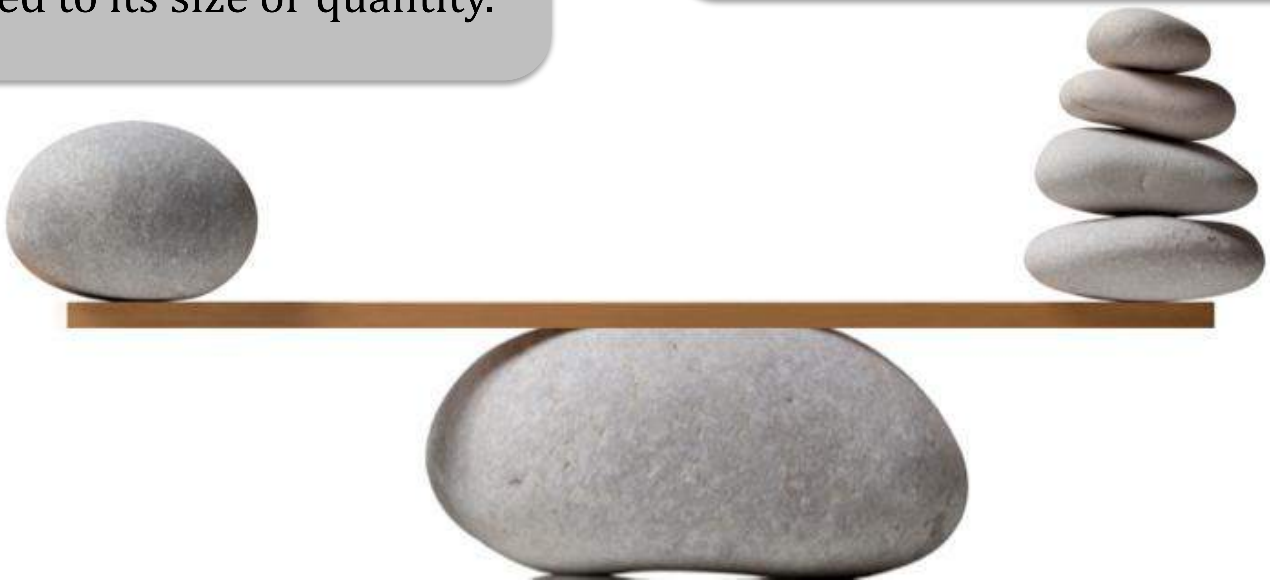
Qualitative

Related to or based on the quality or character of something, often as opposed to its size or quantity.

VS.

Quantitative

Capable of being measured or expressed in numerical terms.



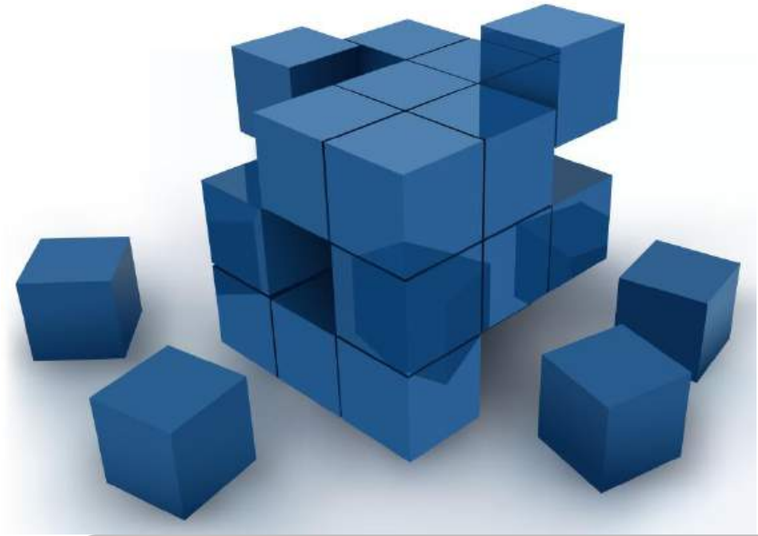
Qualitative Factors – The Company

Qualitative Factors

- Business Model
- Competitive Advantage
- Management
- Corporate Governance
- Customer
- Market Share
- Industry Growth
- Competition
- Regulation

Business Model

Business model is how a company makes money.



Business model is the all encompassing ideology which is driving the revenue of a company.

Competitive Advantage

Ability to maintain the competitive advantage determines a company's sustainability and ability to maintain profitability in the long term.

Competitive advantage can be derived by performing better than rivals by doing different activities or performing similar activities in different ways.

Brand names and patented technologies can also yield competitive advantage.

Management

Management is the most important aspect of investing in a company.

Analysts rely on conference calls, industry and regulatory records for accessing the management of a company.

Corporate Governance

Corporate governance describes the policies in place within an organization denoting the relationships and responsibilities between management, directors and stakeholders.

These policies are defined and determined in the company charter and its bylaws, along with corporate laws and regulations.

The purpose of corporate governance policies is to ensure that proper checks and balances are in place, making it more difficult for anyone to conduct unethical and illegal activities.

Good corporate governance is a situation in which a company complies with all of its governance policies and applicable government regulations in order to look out for the interests of the company's investors and other stakeholders.

Corporate Governance

Corporate Governance Policies has the following aspects:

Financial and Information Transparency	This aspect of governance relates to the quality and timeliness of a company's financial disclosures and operational happenings.
Stakeholder Rights	This aspect of corporate governance examines the extent that a company's policies are benefiting stakeholder interests, notably shareholder interests.
Structure of the Board of Directors	The combination of inside and outside directors attempts to provide an independent assessment of management's performance, making sure that the interests of shareholders are represented.

Customers

Some companies serve only a handful of customers, while others serve millions.

If a company's revenue is dependent only on handful of customers, the loss of each customer will have a significant impact on the revenue of the company.

Market Share

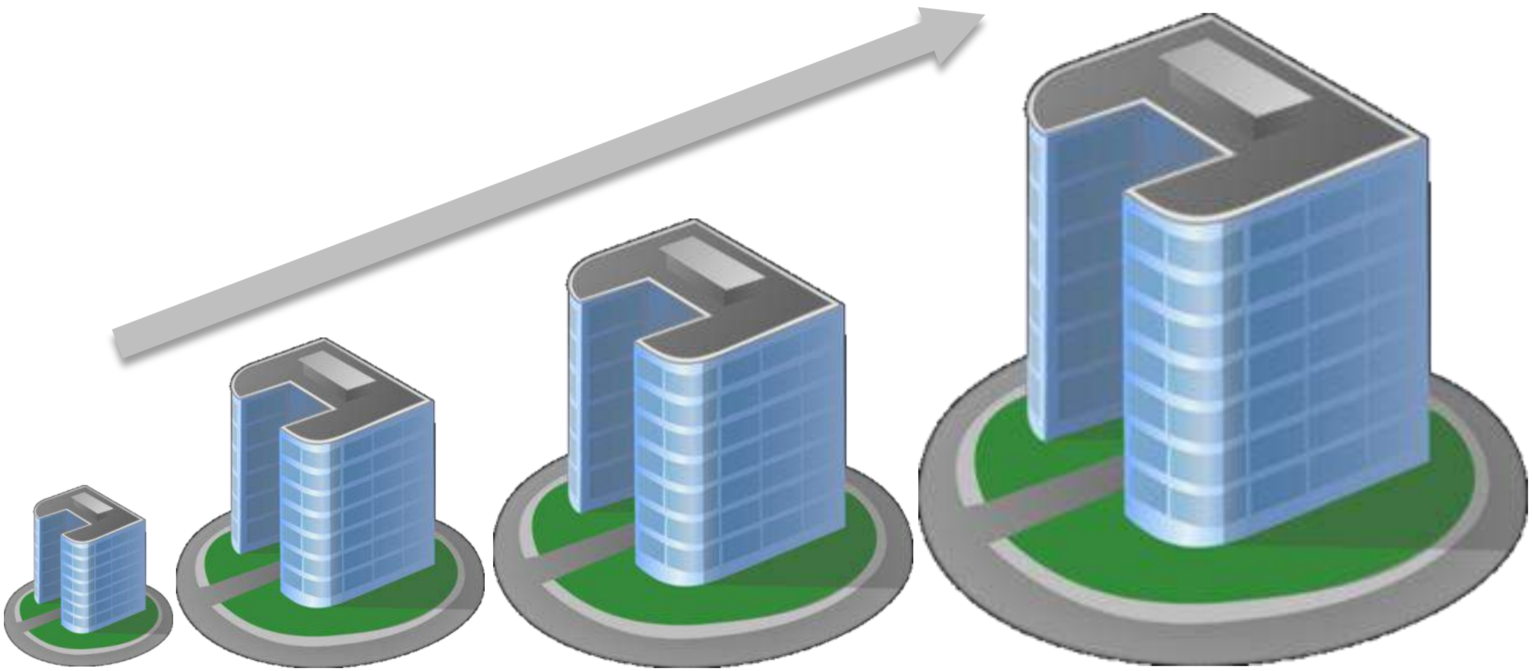
Understanding a company's present market share can tell volumes about the company's business.

A dominant position act as an entry barrier for competitors.

When the firm is bigger than the rest of its rivals, it is in a better position to absorb the high fixed costs of a capital-intensive industry.

Industry Growth

Growth in the industry is very crucial for a company to sustain the revenues and grow from there.



Competition

Industries that have limited barriers to entry and a large number of competing firms create a difficult operating environment for firms.

One of the biggest risks within a highly competitive industry is pricing power.

Companies operating in industries with few alternatives have the ability to pass on costs to their customers.

Regulation

Investors should always be on the lookout for regulations that could potentially have a material impact upon a business' bottom line.

Investors should keep these regulatory costs in mind as they assess the potential risks and rewards of investing.

Annual Report of a Company

- The annual report is a yearly publication by the company and is sent to the shareholders and other interested parties.
- Annual report is published by the end of the Financial Year, and all the data made available in the annual report is dated to 31st March.
- The annual report is published by the company and hence whatever is mentioned in the Annual Report is assumed to be official.
- Any misrepresentation of facts in the annual report can be held against the company.

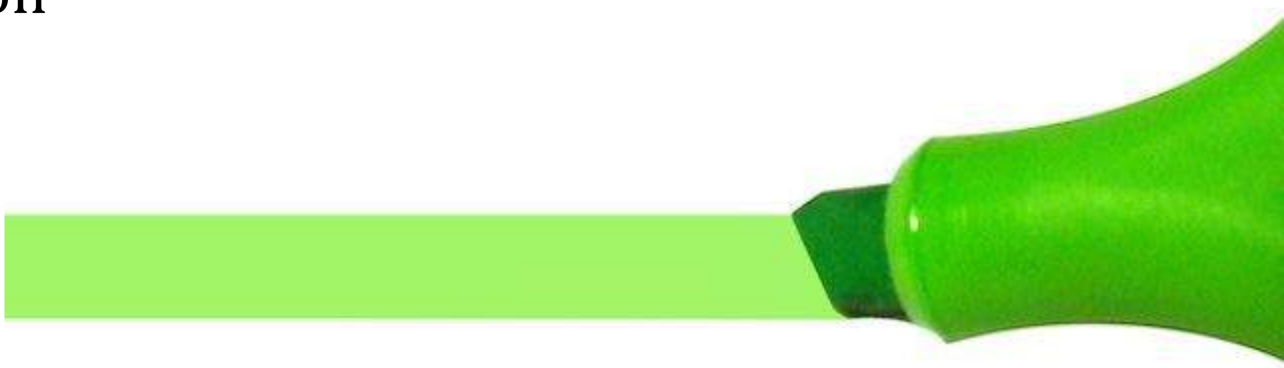
Annual Report of a Company

- Annual Report contains the auditor's certificates (signed, dated, and sealed) certifying the sanctity of the financial data included in the annual report.
- Annual reports should provide the most pertinent information to an investor and should also communicate the company's primary message.
- For an investor, the annual report must be the default option to seek information about a company.

Highlights of an Annual Report

Financial Highlights:

- The Management Statement
- Financial Highlights
- Corporate Information
- Director's Report
- Report on Corporate Governance
- Financial Section
- Notice



Financial Statements

The financial statements are perhaps one of the most important aspects of an Annual Report.

There are three financial statements that the company prepares:

- **Profit and Loss Statement**
- **Balance Sheet**
- **Cash Flow Statement**

Financial Statements

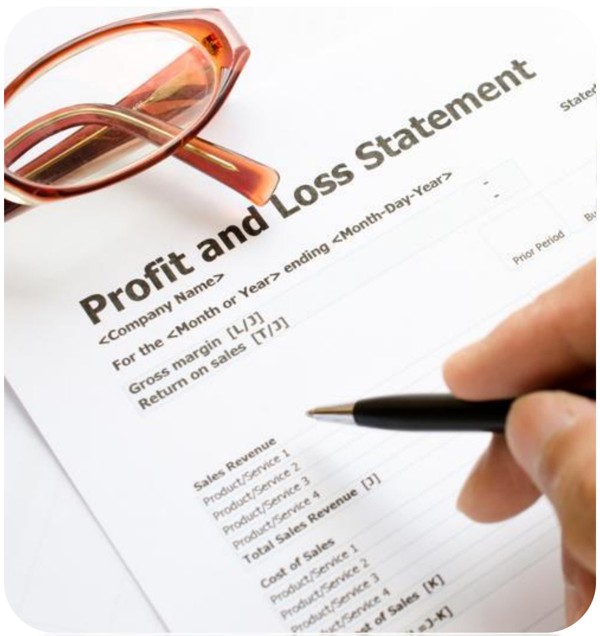
The financial statements comes in two forms:

Standalone Financial Statement

Consolidated Financial Statement – Includes financials of subsidiary companies

The Profit and Loss Statement

The Profit and Loss statement shows what has transpired during a time period. It reports information on:



- The revenue of the company for the given period (yearly or quarterly)
- The expenses incurred to generate the revenues
- Tax and depreciation
- The earnings per share number

The Balance Sheet

- The balance sheet gives us information pertaining to the assets, liabilities, and the shareholders equity.
- It is a statement on companies financial position on a particular day.

Balance Sheet Comprises

- **Assets**
- **Liabilities**
- **Shareholders' Equity**

The Balance Sheet

Assets

- These are economic resources that are expected to produce economic benefits for their owner.

Liabilities

- These are obligations the company has to outside parties.
- It represent others' rights to the company's money or services.
- Examples include bank loans, debts to suppliers and debts to employees.

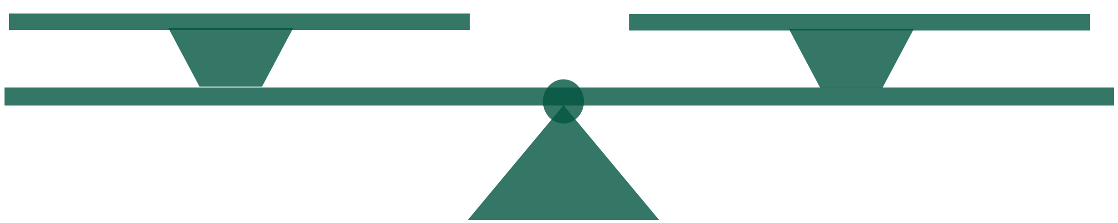
Shareholders' Equity

- It is the value of a business to its owners after all of its obligations have been met.
- This net worth belongs to the owners.
- Shareholders' equity generally reflects the amount of capital the owners have invested, plus any profits generated that were subsequently reinvested in the company.

The Balance Sheet

Balance Sheet Equation

Total Liabilities + **Shareholders' Equity** = **Total Assets**



Assets-side of a Balance Sheet

Current Assets

Assets that may be converted into cash, sold or consumed within a year or less.

- **Cash**
- **Marketable Securities**
- **Accounts Receivable**
- **Inventory**
- **Prepaid Expenses**

Assets-side of a Balance Sheet

Long Term Assets

These are assets that may not be converted into cash, sold or consumed within a year or less.

- **Investments**
- **Fixed Assets**
- **Other Assets**
- **Intangible Assets**

Liabilities-side of a Balance Sheet

Current Liabilities

- Working Capital Loans
- Accounts Payable
- Payable wages, tax and utilities
- Accrued Liabilities/Expenses
- Unearned Revenues/Customer Prepayment
- Dividends Payable
- Current Portion of Long Term Debt
- Current Portion of Capital Lease obligation

Liabilities-side of a Balance Sheet

Long Term Liabilities

- Bank Credit
- Long Term Bonds
- Deferred Tax Liability
- Pension Fund Liability
- Long Term Capital Lease Obligation

Reserves and Surpluses

Securities Premium Reserve/Account

Premium received over and above the face value of the shares.

General Reserve

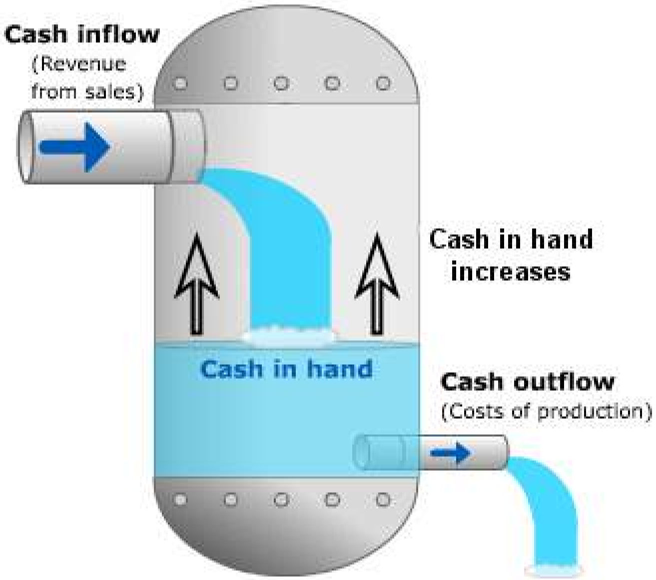
Accumulated profits not distributed to shareholders.

Capital Reserves

- Usually earmarked for long term projects.
- This amount belongs to the shareholders, but cannot be distributed to them.

The Cash Flow Statement

The cash flow statement shows how much cash comes in and goes out of the company over the quarter or the year.



Cash Flow is very much different form a P/L account or an income statement.

The Cash Flow Statement

The P/L Account follows accounting on an accrual basis requires companies to record revenues and expenses when transactions occur, not when cash is exchanged.

P/L Statement

- The P/L account often includes non-cash revenues or expenses.

Cash Flow Statement

- The Cash flow statement does not include non-cash revenues or expenditure.

Sections in Cash Flow Statement

Sections in Cash Flow Statement:

Cash Flow from Operating Activities

Cash Flow from Investing Activities

Cash Flow from Financing Activities

Cash Flow: Operating Activities

Cash comes in

Minus amount of cash needed to make and sell goods and services

XYZ Ltd.

Sales of Goods & Services

This section shows how much cash comes from sales of the company's goods and services, less the amount of cash needed to make and sell those goods and services

Cash Flow: Investing Activities

XYZ Ltd.

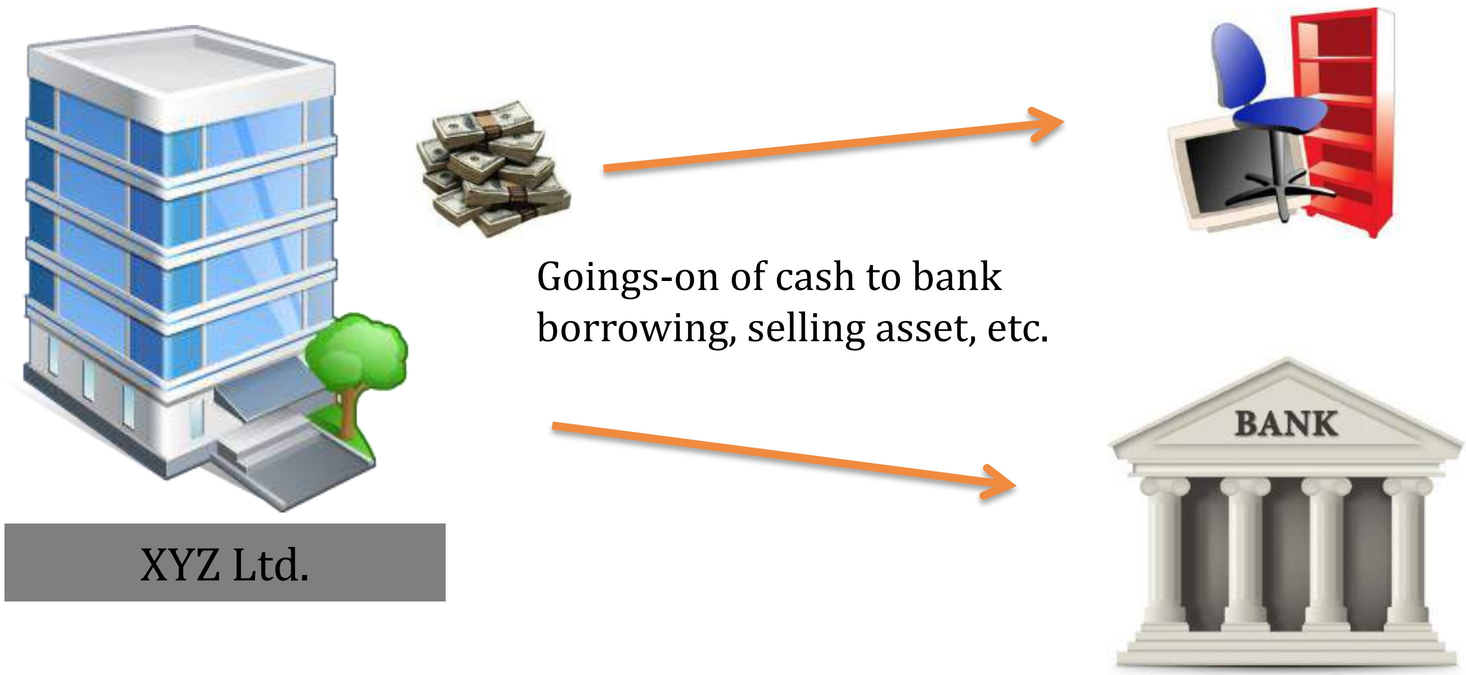
Amount spent on Capital Expenditures

New equipment or other requirements

Acquisitions of other businesses and monetary investments

This section largely reflects the amount of cash the company has spent on capital expenditures and also includes acquisitions of other businesses and monetary investments such as money market funds

Cash Flow: Financing Activities



This section describes the goings-on of cash associated with outside financing activities, bank borrowing, selling Assets etc.

Free Cash Flow

XYZ Ltd.

Free Cash Flow

- Pay Debt
- Pay Dividends
- Buy Back Stock
- Facilitate the Growth of Business

FORMULA

Net Income + Amortization / Depreciation – Changes in Working Capital – Capital Expenditure = Free Cash Flow

Quantitative Analysis

The primary data points for the Quantitative Analysis are obtained from the financial statements of the company.

Fundamental Analysts also relies on data from public domain like Industry Association and regulatory filings.

Quantitative Analysis

Stock Valuation based on quantitative factors can be primarily classified as:

- **Relative Valuation**
  - **Ratio Analysis**
- **Independent Valuation**
  - **CAPM (Capital Asset Pricing Model)**
  - **DCF (Discounted Cash Flow Analysis**

Ratio Analysis

The theory of financial ratios was made popular by Benjamin Graham, who is popularly known as the father of fundamental analysis.

Financial ratios help in interpreting the results, and allows comparison with previous years and other companies in the same industry.

Financial Ratios Classification

- Profitability Ratios
- Leverage Ratios
- Valuation Ratios
- Operating Ratios

The Profitability Ratios

The Profitability Ratio has the followings:

- EBITDA
- PAT (Profit After Tax)
- RoE (Return on Equity)
- RoA (Return on Assets)
- ROCE (Return on Capital Employed)

The Profitability Ratios

- **EBITDA (Earnings before Interest Tax Depreciation & Amortization)**
  - EBITDA Margin tells how profitable the company is at an operating level.

FORMULA

- EBITDA = Operating Revenues – Operating Expense
- Operating Revenues = Total Revenue – Other Income
- Operating Expense =Total Expense – Finance Cost – Depreciation & Amortization

- **PAT (Profit After Tax)** – while calculating the PAT margin, all expenses are deducted from the Total Revenues of the company to identify the overall profitability of the company.

The Profitability Ratios

- **<u>RoE (Return on Equity) -</u>** RoE shows the efficiency of the company in terms of generating profits to its shareholders.

FORMULA

RoE =(Net Profit / Shareholders Equity* 100)

- **<u>RoA (Return on Assets)-</u>** This evaluates the effectiveness of the entity's ability to use the assets to create profits.

FORMULA

RoA = [Net income + interest*(1-tax rate)] / Total Average Assets

- **<u>ROCE (Return on Capital Employed) –</u>** This indicates the profitability of the company taking into consideration the overall capital it employs, and it considers both equity and debt capital.

FORMULA

ROCE = [Profit before Interest & Taxes / Overall Capital Employed]

The Leverage Ratios

Leveraging in the financial parlance means making capital more efficient by borrowing. But it is like a double edged sword.

On one hand it can lead to efficiency of capital by making the company more productive.

On the other side it can over burden the company in terms of excess interest payment and thus affecting the profitability of the company.

The Leverage Ratios

Leverage Ratios intends to give a clue to these:

- Interest Coverage Ratio
- Debt to Equity Ratio
- Debt to Asset Ratio
- Financial Leverage Ratio

The Leverage Ratios

- **<u>Interest Coverage Ratio</u>** - helps to interpret how easily a company can pay its interest payments.

FORMULA

Interest Coverage Ratio = [Earnings before Interest and Tax / Interest Payment]

- **<u>Debt to Equity Ratio</u>** - measures the amount of the total debt capital with respect to the total equity capital.

FORMULA

[Total Debt/Total Equity]

The Leverage Ratios

- **Debt to Asset Ratio** - conveys how much of the total assets are financed through debt capital.

FORMULA

Total Debt / Total Assets

- **Financial Leverage Ratio** - indicates to what extent the assets are supported by equity.

FORMULA

Average Total Asset / Average Total Equity

The Operating Ratios

It indicates the efficiency of the company's operational activities. It is also called Asset Management Ratios, as these ratios indicate the efficiency with which the assets of the company are utilized.

- Fixed Assets Turnover Ratio
- Working Capital Turnover
- Total Assets Turnover Ratio
- Inventory Turnover Ratio
- Inventory Number of Days
- Accounts Receivables Turnover
- Days Sales Outstanding (DSO)

The Operating Ratios

- **Fixed Assets Turnover Ratio** - It tells us how effectively the company uses its fixed assets.

FORMULA

Fixed Assets Turnover = Operating Revenues / Total Average Asset

- **Working Capital Turnover Ratio** – It tell how effectively company finances its current assets with current liabilities.

FORMULA

Working Capital Turnover = [Revenue / Average Working Capital]

- **Inventory Turnover Ratio** – It indicates how quickly a company clears and replenishes its inventory.

FORMULA

Inventory Turnover = [Cost of Goods Sold / Average Inventory]

The Operating Ratios

- **<u>Total Assets Turnover Ratio</u>** - It indicates the company's capability to generate revenues with the given amount of assets. Here the assets include both the fixed assets as well as current assets.

FORMULA

Total Asset Turnover = Operating Revenue / Average Total Assets

- **<u>Inventory Number of Days</u>** - While the Inventory turnover ratio gives a sense of how many times the company 'replenishes' their inventory, the 'Inventory number of Days' gives a sense of how much time the company takes to convert its inventory into cash.

FORMULA

Inventory Number of Days = 365 / Inventory Turnover

The Operating Ratios

- **<u>Accounts Receivables Turnover Ratio</u> -** . The receivable turnover ratio indicates how many times in a given period the company receives money/cash from its debtors and customers. A high number indicates that the company collects cash more frequently.

FORMULA

Accounts Receivable Turnover Ratio = Revenue / Average Receivables

- **<u>Days Sales Outstanding (DSO))/ Average Collection Period/ Day Sales in Receivables</u> -** The days sales outstanding ratio illustrates the average cash collection period i.e. the time lag between billing and collection.

FORMULA

Days Sales outstanding = 365 / Receivable Turnover Ratio

The Valuation Ratios

Valuations dictate the price you pay to acquire a business.

- Price to Sales
- Price to Book Value Ratio
- Price to Earnings Ratio

The Valuation Ratios

- **Price to Sales Ratio** - This ratio compares the stock price of the company with the company's sales per share.

FORMULA

Price to sales ratio = Current Share Price / Sales per Share

- **Price to Book Value Ratio**

FORMULA

  - BV = [Share Capital + Reserves (excluding revaluation reserves) / Total Number of shares]
  - Market Price of the share / BV

- **Price to Earnings Ratio** – P/E Ratio indicates how expensive or cheap the stock is trading at:

FORMULA

Market Price of the Share / Earnings Per Share

Index Valuation

Just Like individual Stock the main indices like BSE Sensex and CNX Nifty values based on:

- Price to Earnings Ratio - P/E
- Price to Book Value Ratio - P/B
- Dividend Yield

Index Valuation is published on a daily basis.

Index Valuation

- The index valuations give us a sense of how cheap or expensive the market is trading at P/E Ratio for Indian indices historically ranges between 16x to 20x.
- The best time to invest in the market is when the P/E ratio is around 16x, below which is an indication than business fundamentals are not good.
- Above 20x shows that markets are over valued.

Generating Stock Idea

General Observation

- **Long**
  - Business Models
  - Earnings Revision
  - Sustainable Growth
- **Short**
  - Euphoria
  - Over Leverage
  - Technology Obsolescence

Generating Stock Idea

Macro Trends

- Government Policies
- Shift in Consumption Patterns

Special Situations

- Mergers & Acquisition
- Management Change
- Spin - offs

Sectoral Trends

- Industry Growth Rates
- Entry of New Players
- Regulatory changes

Moat – It's concept popularized by Warren Buffet, which means The competitive advantage that one company has over other companies in the same industry.

Discounted Cash Flow Analysis

The objective of analyzing DCF is to find out the intrinsic value of the stock.

- Estimate the average Free Cash Flow
- Estimate the Growth in FCF
- Estimate the Future Cash Flow
- Estimate the Terminal Value
  - Terminal value is the sum of all future cash flows beyond the final year of analysis to infinity

Discounted Cash Flow Analysis

Estimating the average Free Cash Flow is the excess of operating cash a company generates after accounting for capital expenditure

FORMULA

FCF = Cash from Operating Activities – Capital Expenditures

- Taking average helps to:
  - Account cyclical nature of the business
  - Average out the extreme cash flows

Discounted Cash Flow Analysis

Calculating the Net Present Value of Future Cash Flows

FORMULA

Share Price = Total Present Value of Free Cash flow / Total Number of shares

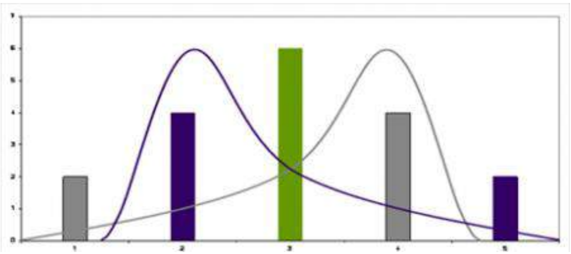
- **<u>Modeling Error :</u>** Since DCF is based on lot assumptions a leeway for modeling error is allowed and the intrinsic value is expressed in a range:
  - If the Stock price is lower the intrinsic value band –Stock is under valued
  - If the stock price is within the intrinsic value band – The stock considered to be a hold
  - If the stock prices are above the intrinsic value band – Stock is overvalued

Drawbacks of DCF Analysis

Requires to forecast

Highly sensitive to terminal growth rate

Requires constant updates



Heavily skewed for long term investment

Business Model and Stock Price

For a long term investor, it is important to focus more on the business model.

In the short term stock prices can get affected by the market fluctuations.

Understanding the business model helps the investor to decide whether to stay put in a stock during bear phase.

Bear markets act as a value creator for companies with sound business model.

Top-Down and Bottom-Up Approach

It is the strategy for information processing.

Top Down	Bottom Up
• Considers the big picture of Economy, Industry and Company • Consider Macro Economic Factors like GDP, Unemployment, Inflation etc • Consider Macro Economic Factors and Identify the Growth Sectors in economy and focuses on top companies from the sector	• Overlook the big picture and focus on company specific reason • Focus on company valuation uses measures like P/E Ratio • Analyse only company valuation

Investment Style

Choice of Investment Style depends on

- Risk Profile
- Return Expectation
- Consistency of Return
- Investment Horizon

Based on the above objectives investment styles can be classified as:

- Growth Investment
- Value Investment

Growth Investment Vs Value Investment

Growth Investment	Value Investment
Focuses on Future price of the company with less emphasis on Current Price	Looks for Companies trading less than its intrinsic value at the moment
Looks for companies which are outperformers	Looks for consistent growth
Invests in relatively young and midcap companies	Invests in established large cap companies
High Risk investment with extreme price volatility	Low risk with consistent growth
Low Dividend Paying companies	High Dividend Paying companies

Technical Analysis

Technical Analysis

Technical Analysis is an attempt predict the stock prices based past trading patterns.

Technical Analysts believes that in the short run psychological factors drives the stock prices.

Technical Analysis

Technical Analysis is a methodology which uses Price and Volume for forecasting the direction of share prices.

It is widely used by the short term day traders and not by the long term investors.

This can be complementary to fundamental analysis for calibrating entry and exit points.

In forex market, use of technical analysis is more wide spread than the fundamental analysis.

Technical Analysis: Basic Assumptions

The market discounts everything

Price moves in trends

History tends to repeat itself

Market Discounts Everything

- Technical analysts believe that the company's fundamentals, along with broader economic factors and market psychology, are all priced into the stock.
- This removes the need for considering the major factors separately and leaves only the price to be analysed.
- Price is a result of demand and Supply.

Price Moves in Trends

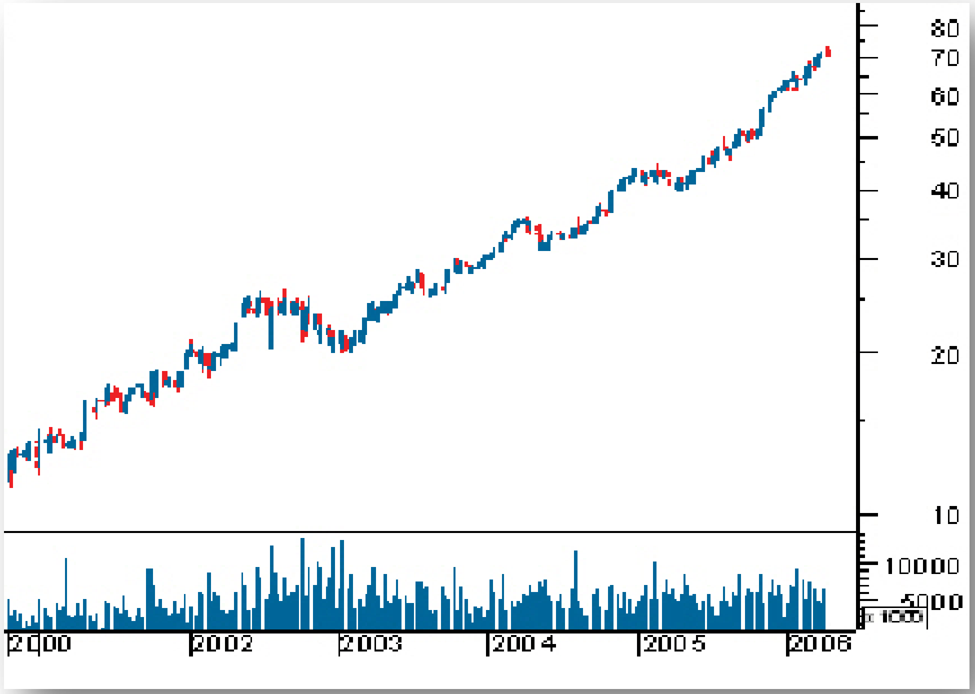
- All major moves in the market is an outcome of a trend.
- This means that after a trend has been established, the future price movement is more likely to be in the same direction as the trend.

History Tends to Repeat Itself

- The repetitive nature of price movements is attributed to market psychology.
- Market participants tend to provide a consistent reaction to similar market stimuli over time.
- Technical analysis uses chart patterns to analyze market movements and understand trends.

Trend Analysis

Trend is the general direction in which a security or market is headed.



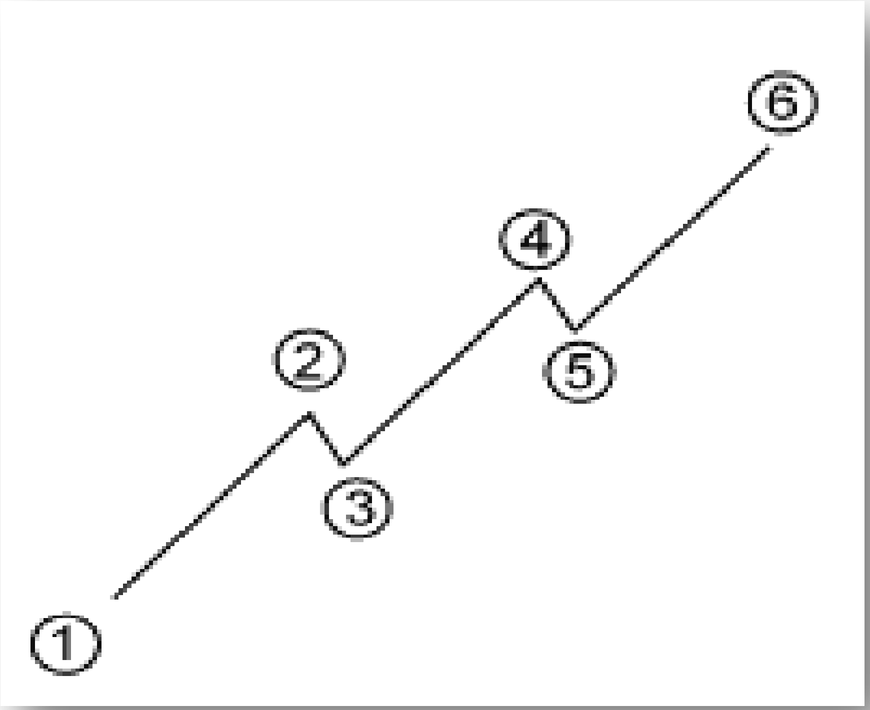
It is easy to depict that trend in the above diagram is up.

Trend Analysis

It won't be always easy to depict the case in a diagram. Defining a trend goes well beyond the obvious.

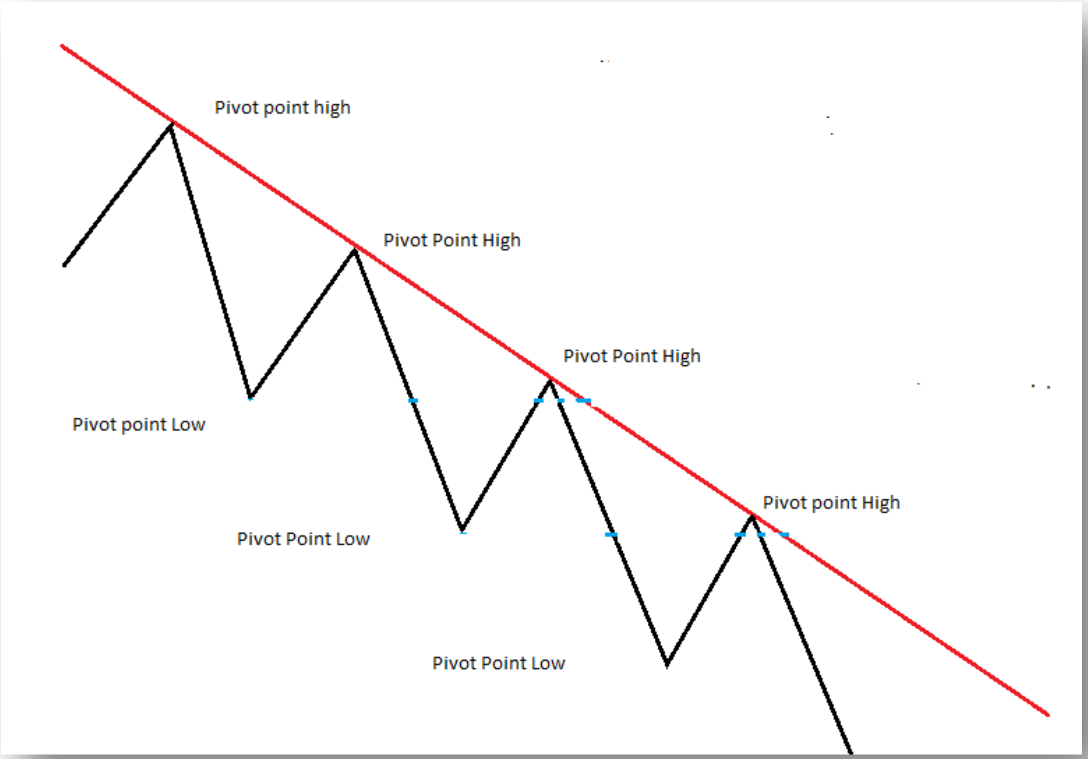
Types of Trends – UP Trend

- In technical analysis, it is the movement of the highs and lows that constitutes a trend.
- An UP trend is classified as a series of higher highs and higher lows.



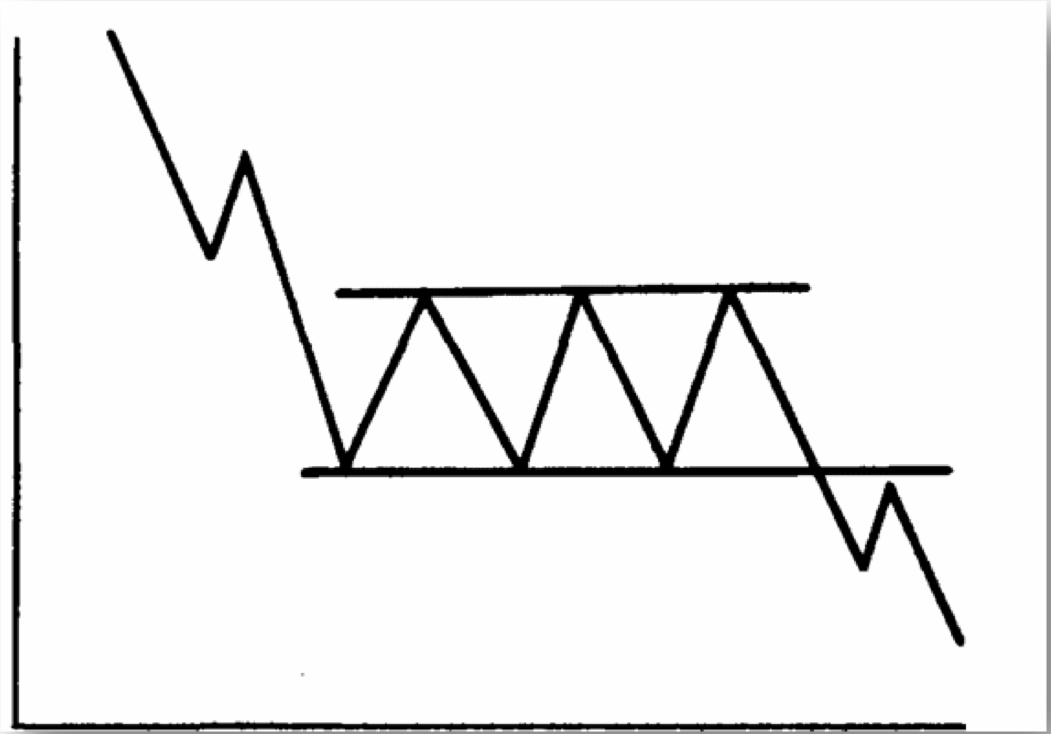
Types of Trends – Down Trend

A downtrend is one of lower lows and lower highs.



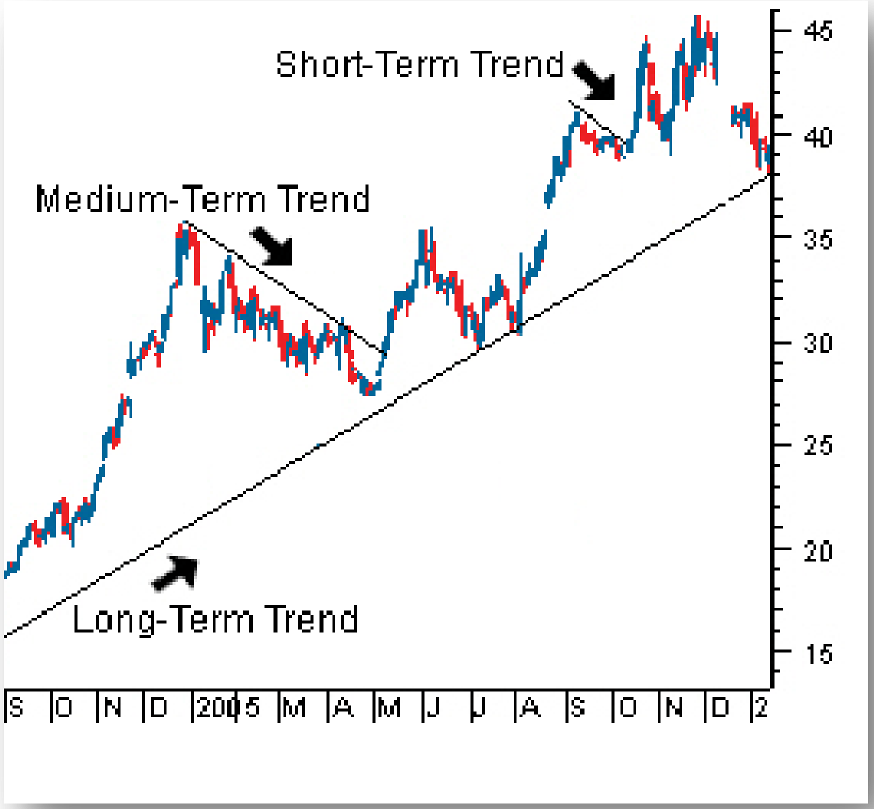
Types of Trends – Horizontal Trend

When there is little movement up or down in the peaks and troughs, it's a sideways or horizontal trend.



Trend Lengths

- A trend of any direction can be classified as:
  - Long-term Trend
  - Intermediate Trend
  - A Short-term Trend



Trend Lengths

- In terms of the stock market, a major trend/Long Term Trend is generally categorized as one lasting longer than a year.
- An intermediate trend is considered to last between one and three months.
- A near-term trend/Short Term Trend is anything less than a month.
- A long-term trend is composed of several intermediate trends, which often move against the direction of the major trend.

Trend Lengths

- If the major trend is upward and there is a downward correction in price movement followed by a continuation of the uptrend, the correction is considered to be an intermediate trend.
- The short-term trends are components of both major and intermediate trends.
- To identify long-term trends, weekly charts or daily charts spanning a five-year period are used .
- Daily data charts are best used when analyzing both intermediate and short-term trends.

Trendlines

A trendline is a simple charting technique that adds a line to a chart to represent the trend in the market or a stock.

These lines are used to clearly show the trend and are also used in the identification of trend reversals.

Trendlines

- An upward trendline is drawn at the lows of an upward trend.
- This line represents the support the stock has every time it moves from a high to a low
- This type of trendline helps traders to anticipate the point at which a stock's price will begin moving upwards again.

Trendlines

A downward trendline is drawn at the highs of the downward trend.

The line represents the resistance level that a stock faces every time the price moves from a low to a high.

Channels

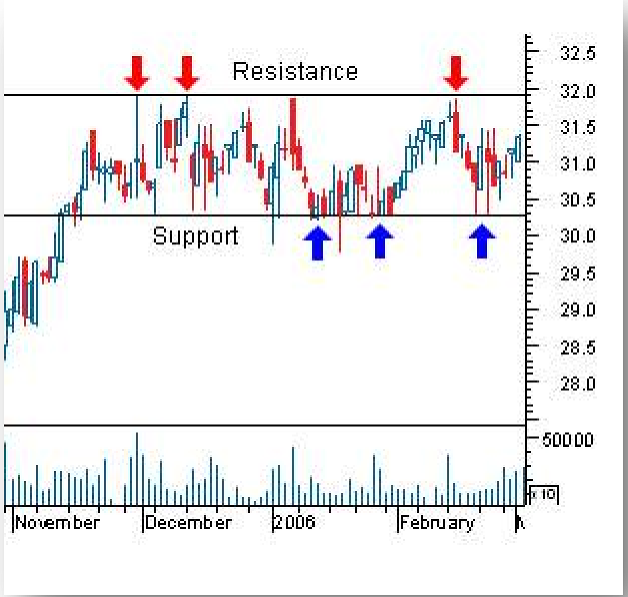
A channel, or channel lines, is the addition of two parallel trendlines that act as strong areas of support and resistance.

Channels

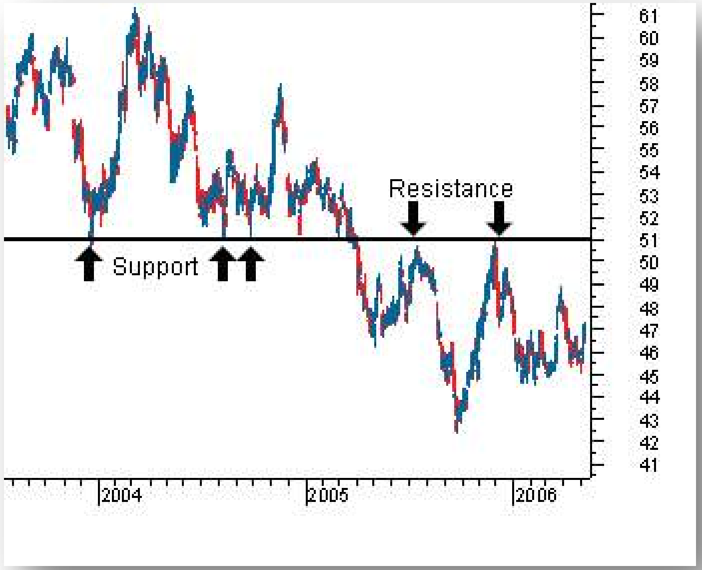
- The upper trendline connects a series of highs, while the lower trendline connects a series of lows.
- A channel can slope upward, downward or sideways.
- Traders will expect a given security to trade between the two levels of support and resistance until it breaks beyond one of the levels.
- During Breakouts traders can expect a sharp move in the direction of the break.
- Channels are mainly used to illustrate important areas of support and resistance.

Support and Resistance

- Support is the price level through which a stock or market seldom falls (illustrated by the blue arrows).
- Resistance, on the other hand, is the price level that a stock or market seldom surpasses (illustrated by the red arrows).
- Support and resistance levels are the levels at which a lot of traders are willing to buy the stock (in the case of a support) or sell it (in the case of resistance).
- When these trendlines are broken, the supply and demand and the psychology behind the stock's movements is thought to have shifted, and new levels of support resistance will be established.



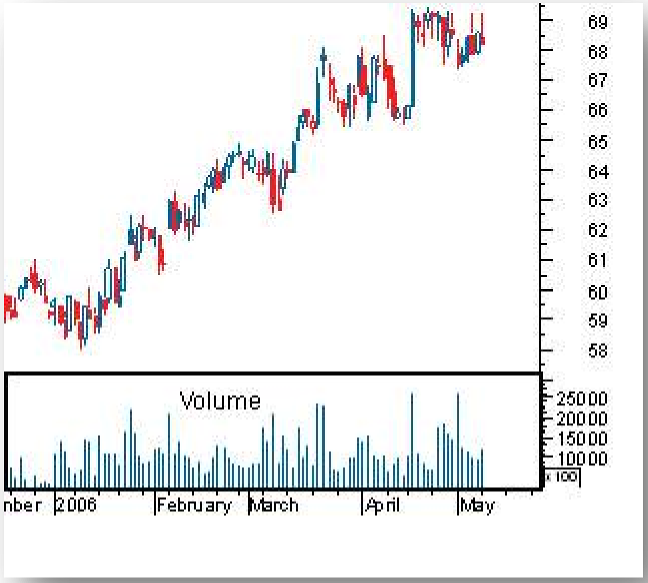
Support and Resistance – Role Reversal



- Once a resistance or support level is broken, its role is reversed.
- If the price falls below a support level, that level will become resistance.
- If the price rises above a resistance level, it will often become support.

Importance of Volume

- Volume is simply the number of shares or contracts that trade over a given period of time, usually a day.
- The higher the volume, the more active the security.
- To determine the movement of the volume (up or down), chartists look at the volume bars that can usually be found at the bottom of any chart.



Importance of Volume

Any price movement up or down with relatively high volume is seen as a stronger, more relevant move than a similar move with weak volume.

If volume is high during the day relative to the average daily volume, it is a sign that the reversal is probably for real.

Importance of Volume

Volume should move with the trend.

Volume confirms Chart Patterns.

Volume precedes Price.

If prices are moving in an upward trend, volume should increase (and vice versa).

If the stock is in an uptrend but the up trading days are marked with lower volume, it is a sign that the trend is starting to lose its legs and may soon end.

Summarizing a Trading Pattern

A good way to summarize the daily trading action is by marking the open, high, low and close prices.

Summarizing a Trading Pattern

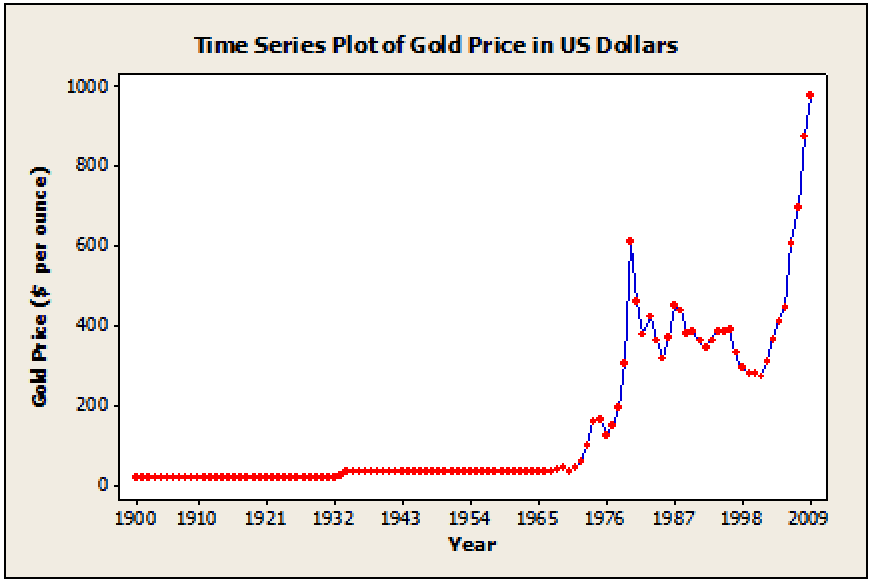
Open Price	It is the first price at which a trade executes.
High Price	This represents the highest price at which the market participants were willing to transact for the given day.
Low Price	This represents the lowest level at which the market participants were willing to transact for the given day.
Close Price	The final price at which the market closed. It serves as an indicator for the intraday strength. If the close is higher than the open, then it is considered a positive day else negative.

Technical Analysis - Chart

A chart is simply a graphical representation of a series of prices over a set time frame.

Basic Factors which affects the information provided in the chart are:

- Time Scale
- Price Scale
- Price Point Properties



The Time Scale

The time scale refers to the range of dates at the bottom of the chart. It can vary from decades to seconds.

Most frequently used time scales

Intraday	Daily
Weekly	Monthly
Quarterly	Annually

The Time Scale

Each data point can represent the followings:

Open Price

High Price

Low Price

Close Price

Each data point in the graphs will be a condensed version of what happened over the specified period.

The Price Scale and Price Point Properties

- The price scale is on the right-hand side of the chart.
- It shows a stock's current price and compares it to past data points.
- Structure of the Scale can be Linear or Logarithmic.

The Price Scale and Price Point Properties

- If a price scale is constructed using a linear scale, the space between each price point (10, 20, 30, 40) is separated by an equal amount.
- The linear price scale measures moves in absolute terms and does not show the effects of percent change.
- In a logarithmic scale the distance between points will be equal in terms of percent change.

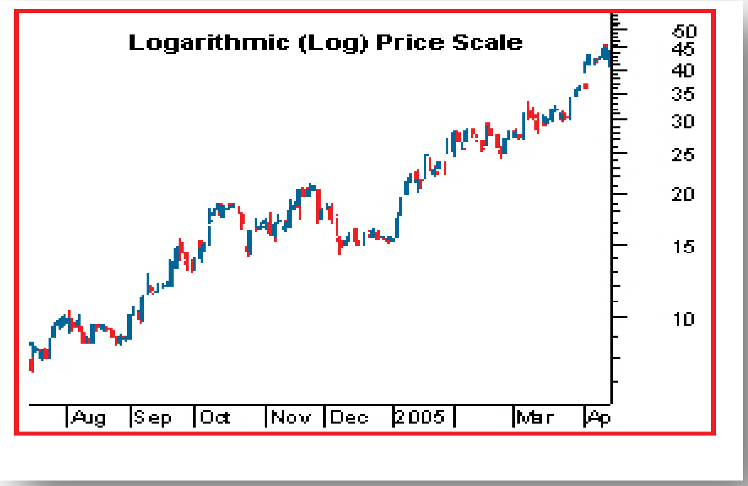
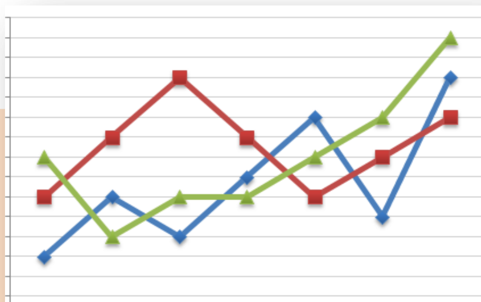


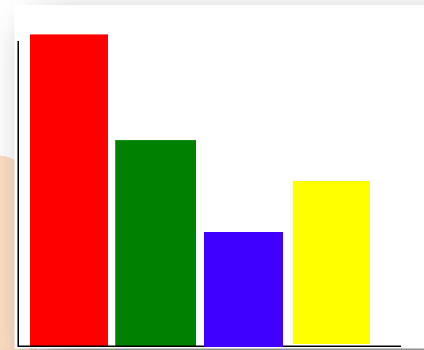
Chart Types

There are four main types of charts:

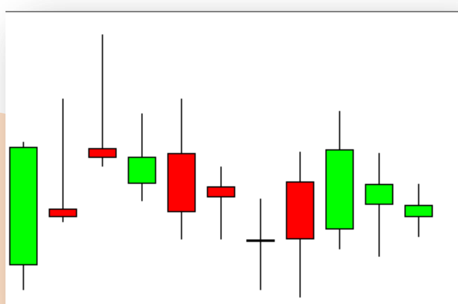
Line Chart



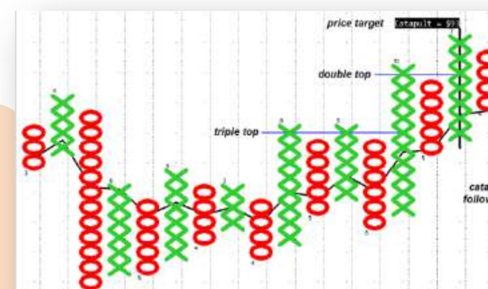
Bar Chart



Candlestick Chart

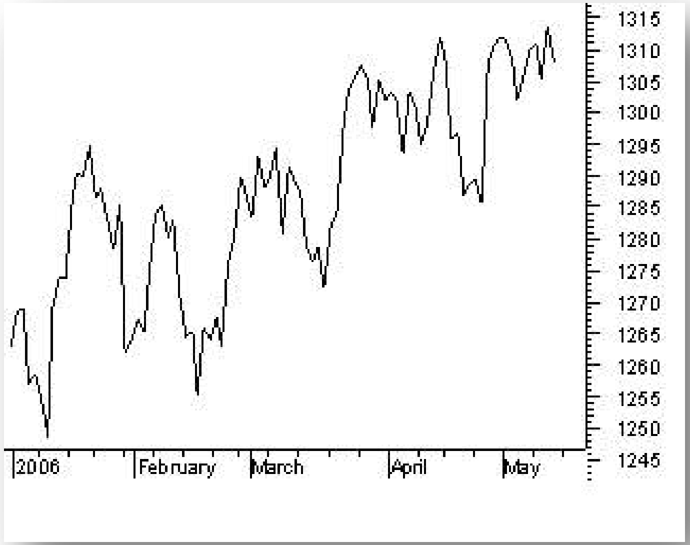


Point and Figure Chart



The Line Chart

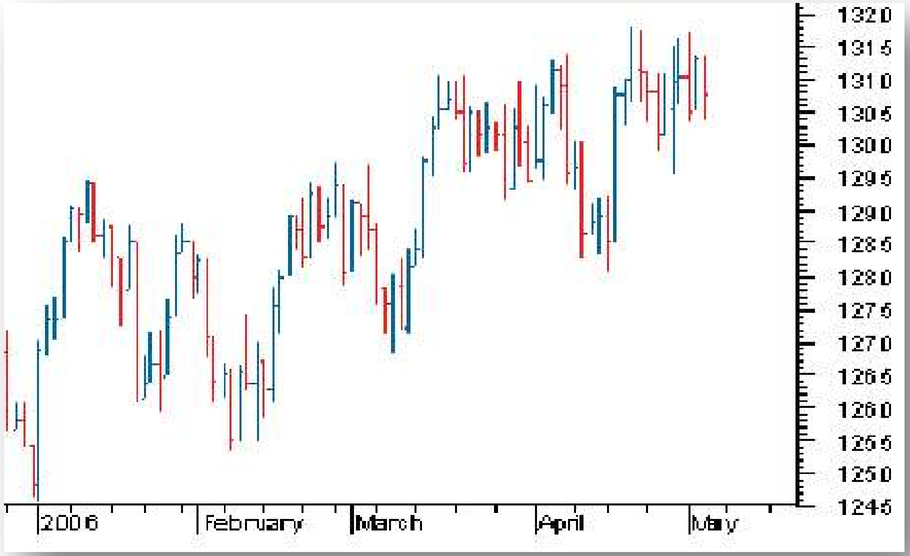
The Line chart is the most basic of the four charts.



- It represents only the closing prices over a set period of time.
- The line is formed by connecting the closing prices over the time frame.
- Line Chart does not Provide information of the trading range for the individual points such as the high, low and opening prices.

The Bar Chart

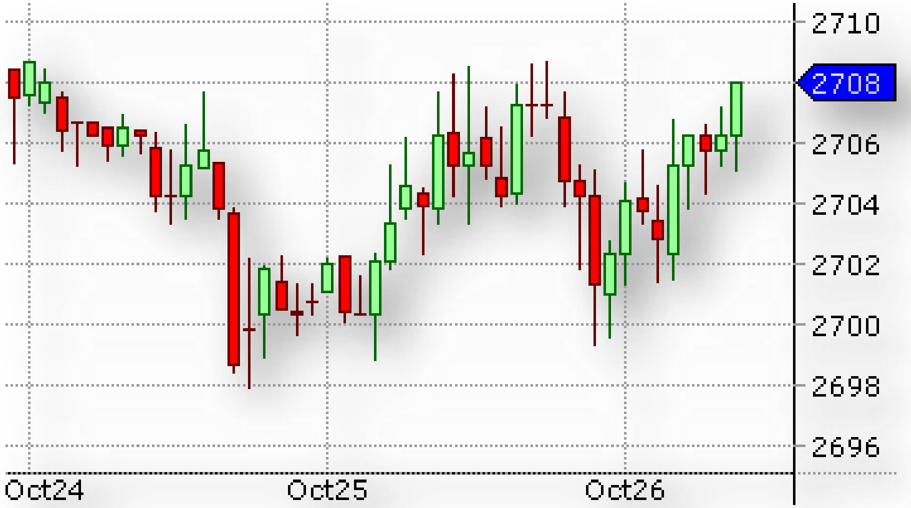
The chart is made up of a series of vertical lines that represent each data point, and provides information on Open, Close, High and Low Prices.

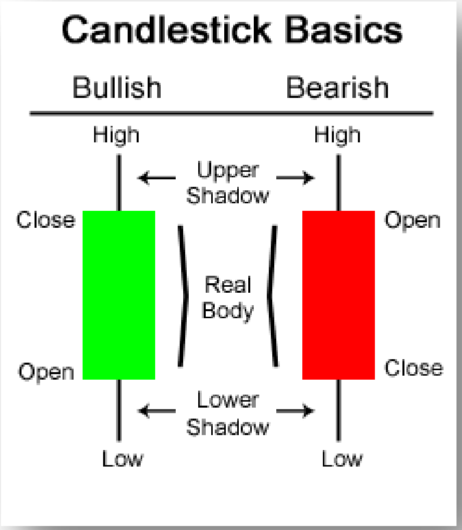


- The Opening and Closing Price is represented by the dash on the left side of the vertical line.
- If the left dash (open) is lower than the right dash (close) then the bar will be shaded black, representing an up period for the stock.
- If the right dash is lower than the left dash, the bar will be shaded black.

The Candlestick Chart

In a candlestick the open and close prices are displayed by a rectangular body.

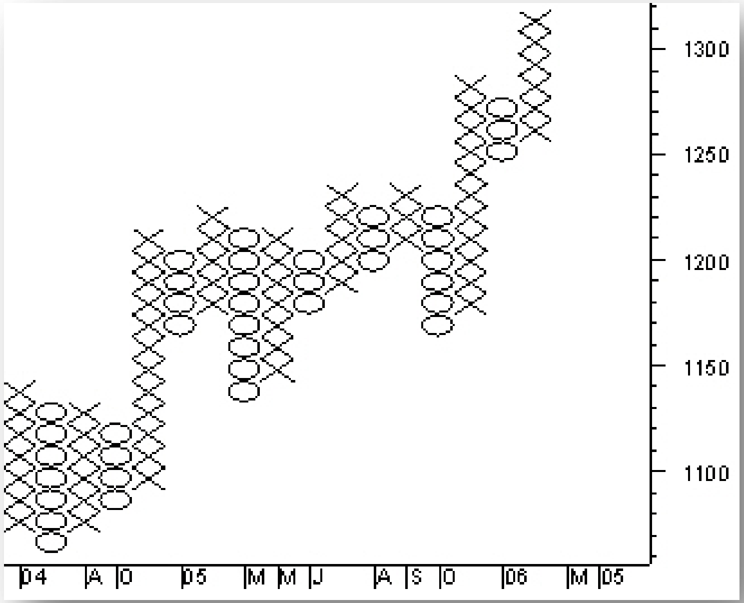




- Color of the rectangular body denotes whether the price has closed high or low.
- Green represents a bullish candle and red represents a bearish candle
- Candlesticks help you to quickly visualize the relationship between the open and close as well as the high and low price points.
- Shadows connect the respective high and low prices to the main body.

The Point and Figure Chart

The Point and Figure Chart is not well known and used by average investors.



- This type of chart reflects price movements and is not as concerned about time and volume in the formulation of the points.
- The Xs represent upward price trends.
- Os represent downward price trends.

Chart Patterns

A chart pattern is a distinct formation on a stock chart that creates a trading signal, or a sign of future price movements.

The idea is that certain patterns are seen many times, and that these patterns signal a certain high probability move in a stock.

While there are general ideas and components to every chart pattern, there is no chart pattern that will tell you with 100% certainty where a security is headed.

Chart Patterns

Types of Patterns

Reversal

A reversal pattern signals that a prior trend will reverse upon completion of the pattern.

Continuation

A continuation pattern, on the other hand, signals that a trend will continue once the pattern is complete.

Head and Shoulders

Head and shoulders is a reversal chart pattern that when formed, signals that the security is likely to move against the previous trend.

Head and shoulders top is a chart pattern that is formed at the high of an upward movement and signals that the upward trend is about to end.

Head and Shoulders

Chart has four main parts: two shoulders, a head and a neckline. The neckline is a level of support or resistance.

Head and Shoulders bottom, also known as inverse head and shoulders is used to signal a reversal in a downtrend.

Cup and Handle

A cup and handle chart is a bullish continuation pattern in which the upward trend has paused but will continue in an upward direction once the pattern is confirmed.

- The handle follows the cup formation and is formed by a generally downward/ sideways movement in the security's price.
- Once the price movement pushes above the resistance lines formed in the handle, the upward trend can continue.

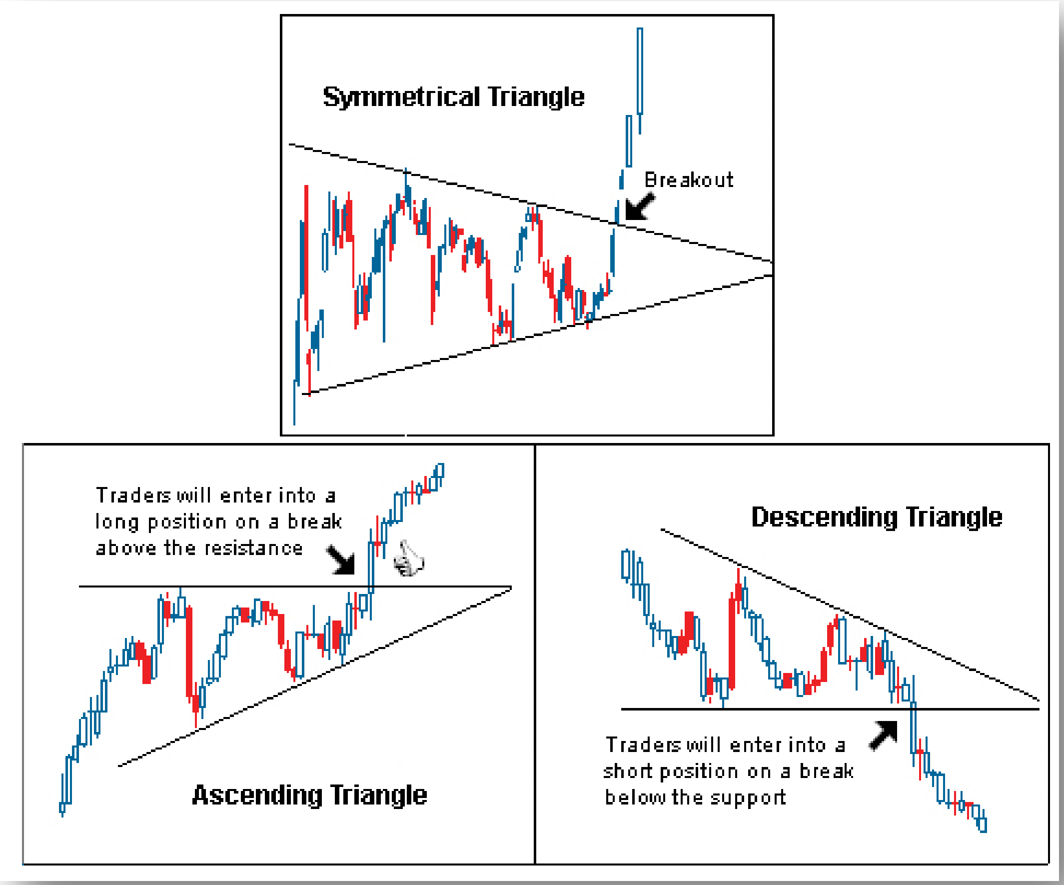
Double Tops and Bottoms

This pattern is created when a price movement tests support or resistance levels twice and is unable to break through.

This pattern is often used to signal intermediate and long-term trend reversals.

Triangles

There are three types of triangle formation:



Triangles

Symmetrical Triangle

This is a pattern in which two trendlines converge toward each other. This pattern is neutral in that a breakout to the upside or downside is a confirmation of a trend in that direction.

Ascending Triangle

In this type, the upper trendline is flat, while the bottom trendline is upward sloping. This is generally thought of as a bullish pattern in which chartists look for an upside breakout.

Descending Triangle

In a descending triangle, the lower trendline is flat and the upper trendline is descending. This is generally seen as a bearish pattern where chartists look for a downside breakout.

Flag and Pennant

This patterns are formed when there is a sharp price movement followed by a generally sideways price movement.

Flag and Pennant

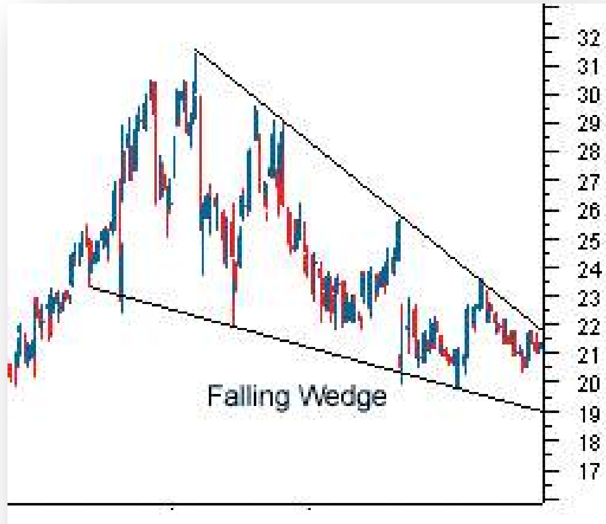
This pattern is then completed upon another sharp price movement in the same direction as the move that started the trend.

In a pennant, the middle section is characterized by converging trendlines.

The middle section on the flag pattern, on the other hand, shows a channel pattern, with no convergence between the trendlines.

In both cases, the trend is expected to continue when the price moves above the upper trendline.

Wedge



- The wedge chart pattern can be either a continuation or reversal pattern.
- A falling wedge is bullish and a rising wedge is bearish.
- If the price was to rise above the upper trendline, it would form a continuation pattern, while a move below the lower trendline would signal a reversal pattern.

Gaps

- A gap occurs when there is a large difference in prices between two sequential trading periods.
- Gap price movements can be found on bar charts and candlestick charts but will not be found on point and figure or basic line charts.
- Gaps generally show that something of significance has happened in the security, such as a better-than-expected earnings announcement.

There are three main types of gaps:

Breakaway

A breakaway gap forms at the start of a trend.

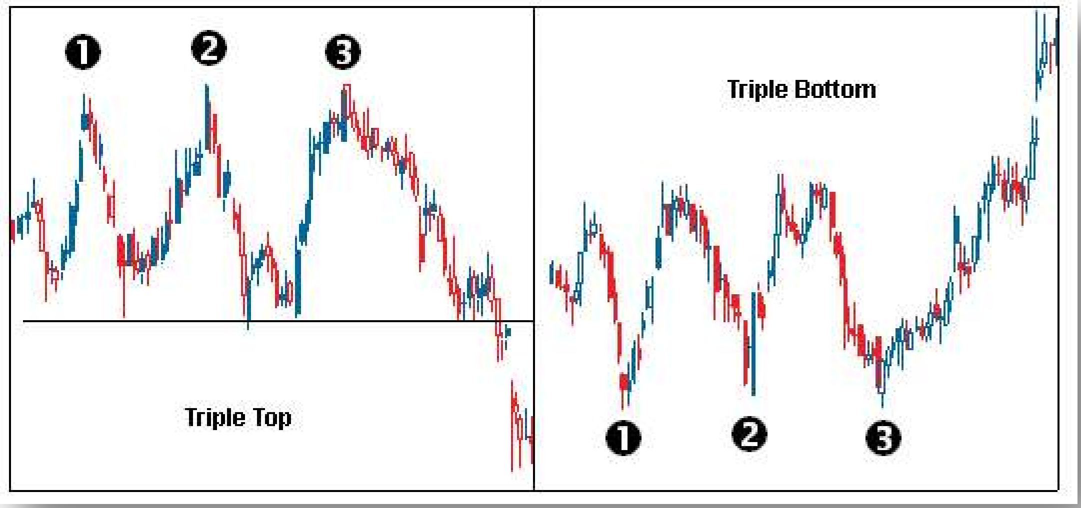
Runaway

A runaway gap forms during the middle of a trend.

Exhaustion

An exhaustion gap forms near the end of a trend.

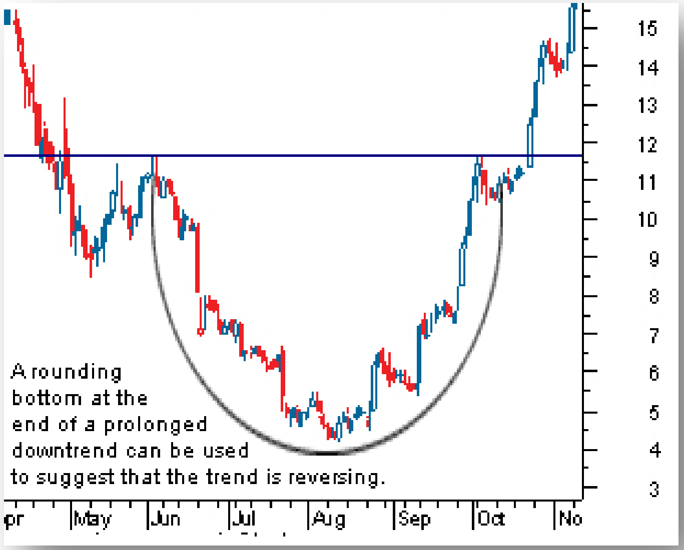
Triple Tops and Bottoms



These chart patterns are formed when the price movement tests a level of support or resistance three times and is unable to break through; this signals a reversal of the prior trend.

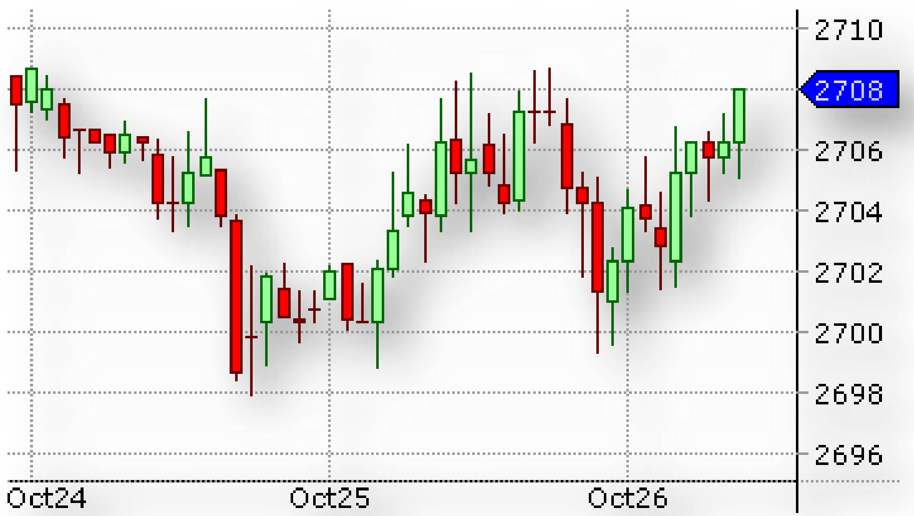
Rounding Bottom or Saucer Bottom

It is a long-term reversal pattern that signals a shift from a downward trend to an upward trend.

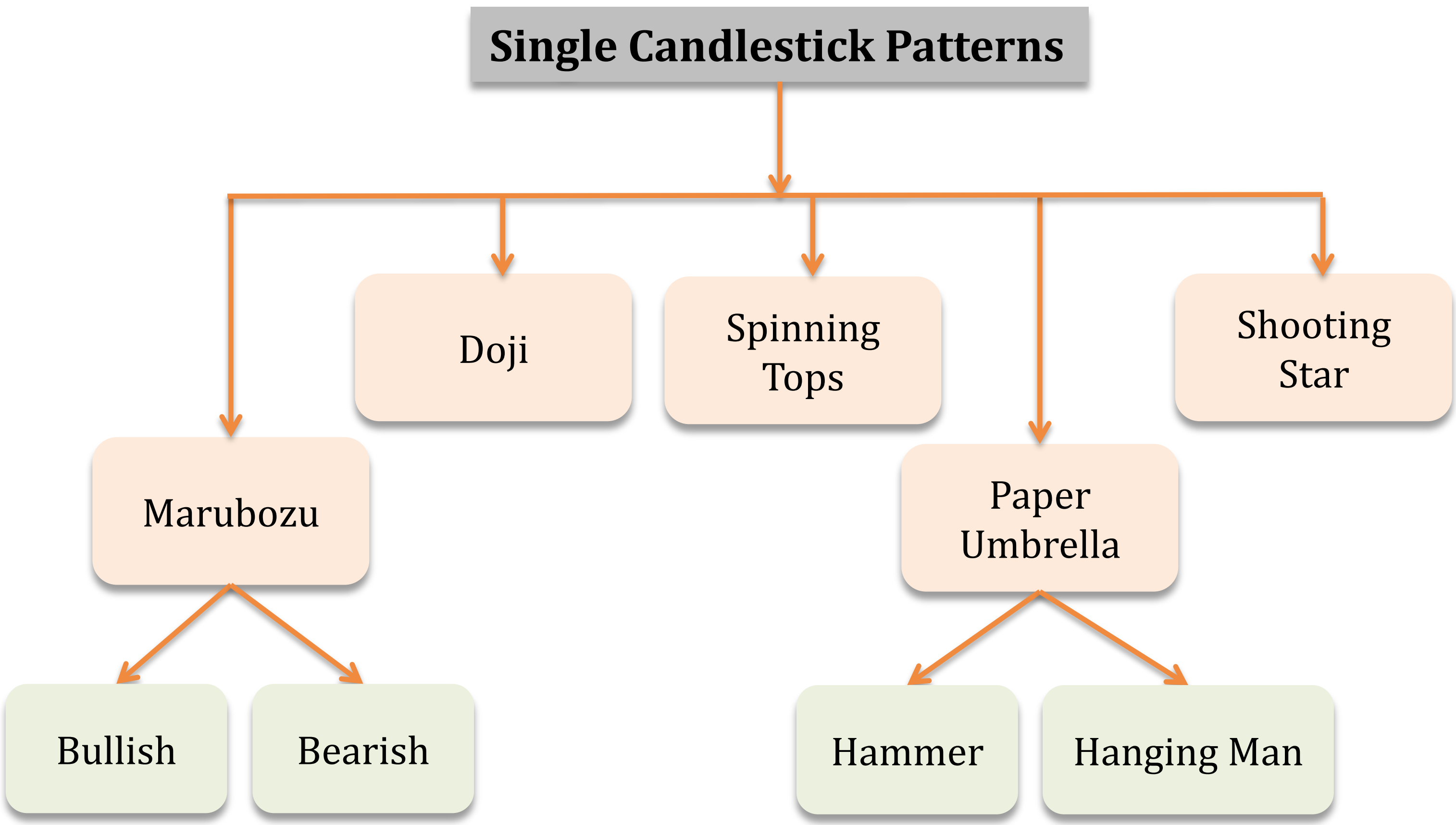


Candlestick Patterns

- Candlestick patterns helps the technical analysts to set up a trade.
- Patterns are explained either using a singe candlestick or a group of candle sticks.
- Based on this Candlestick pattern are classified as Single Candle stick or Multiple Candle Stick.



Candlestick Patterns



Assumption Specific to Candlestick

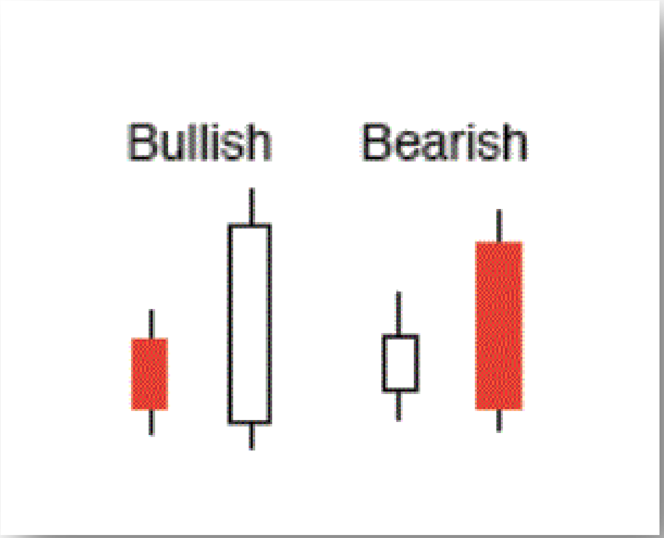
- Strength is represented by a bullish (blue) candle and weakness by a bearish (red) candle.
- Buying should be done on a Blue candle day and Selling should be done on a red candle day.

Buy Strength

Sell Weakness

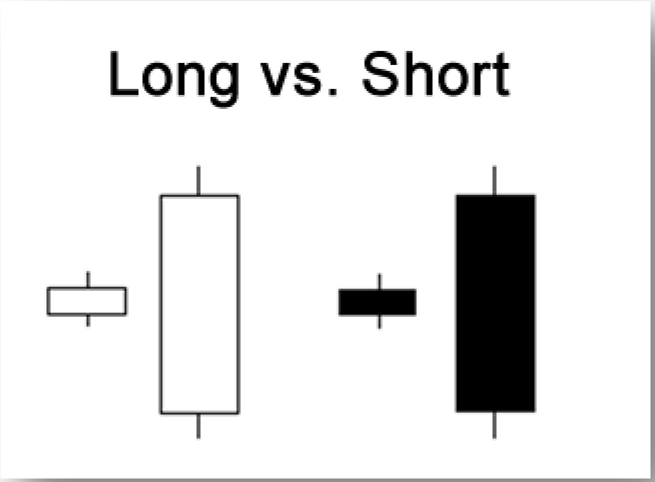
Assumption Specific to Candlestick

- Flexibility with the Patterns:
  - Patterns can vary due to market conditions. So it is important to be flexible within limits. So it is important to quantify the flexibility.
- Look for prior trend:
  - If you are looking at a bullish pattern, the prior trend should be bearish.
  - If you are looking for a bearish pattern, the prior trend should be bullish.



Single Candle Stick Patterns

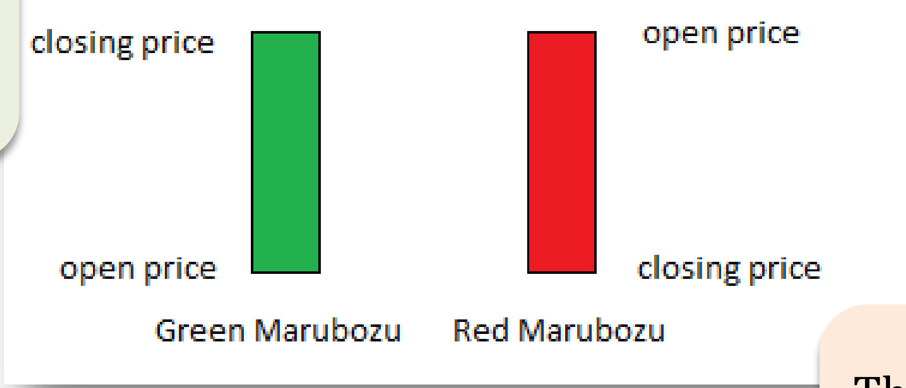
- Single candlestick pattern is formed by just one candle.
- The trading signal is generated based on 1 day's trading action.
- One needs to pay some attention to the length of the candle while trading based on candlestick patterns.
- The length signifies the range for the day.
- The longer the candle, the more intense is the buying or selling activity.
- If the candles are short, it can be concluded that the trading action was subdued.



Marubozu

The word Marubozu means "Bald" in Japanese. Marubozu is a candlestick with no upper and lower shadow.

The Green candle represents a Bullish Marubozu.



The Red candle represents a Bearish Marubozu.

Bullish Marubozu

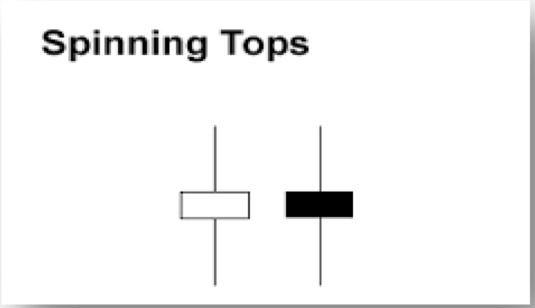
- The absence of the upper and lower shadow in a bullish Marubuzo implies that the low is equal to the open and the high is equal to the close.
- A bullish Marubuzo indicates that there is so much buying interest in the stock that the market participants were willing to buy the stock at every price point during the day, so much so that the stock closed near its high point for the day.
- The buy price should be around the closing price of the Marubuzo.
- In case of a bullish Marubuzo, the low of the stock acts as a stoploss.

Bearish Marubozu

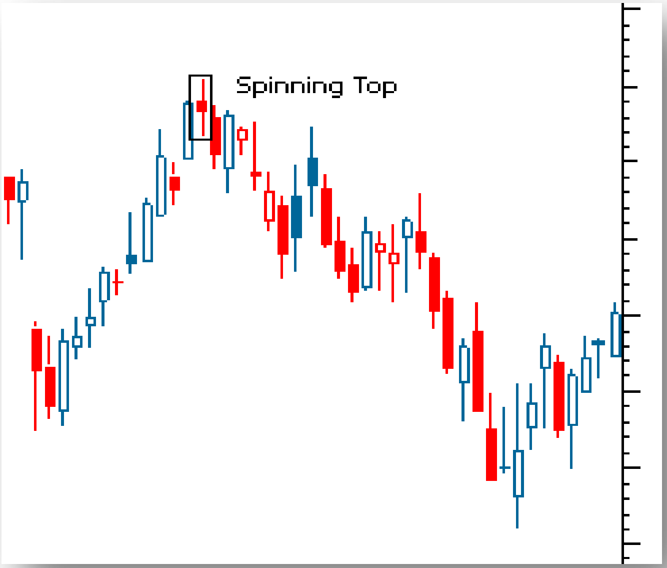
- In Bearish Marubozu, open is equal to the high and close the is equal to low.
- A bearish marubuzo indicates that there is so much selling pressure in the stock that the market participants actually sold at every price point during the day, so much so that the stock closed near its low point of the day.
- The sell price should be around the closing price of the marubuzo.
- Stop loss would be at the high point of the candle.

The Spinning Top

- Spinning Top does not give the trader a trading signal with specific entry or an exit point.
- However, the spinning top gives out useful information with regard to the current situation in the market.
- A Spinning Top in isolation it does not mean much.
- It just conveys indecision as both bulls and bears were not able to influence the markets.
- However, when you see the spinning top with respect to the trend in the chart it gives out a really powerful message based on which a trader can position his stance in the markets.



Spinning Top in a Downtrend



- With the spinning top in the down trend the bears could be consolidating their position before resuming another bout of selling.
- Also, the bulls have attempted to arrest the price fall and have tried to hold on to their position, though not successfully.

Spinning Top in a Uptrend

The spinning top basically conveys indecision in the market i.e. neither the bulls nor the bears are able to influence the markets.

- Placing the above fact in the context of an uptrend we can conclude two things.
  - The bulls could be consolidating their position before initiating another leg of up move.
  - Or the bulls are fatigued and may give way to bears. Hence a correction could be around the corner.
- The chances of both these events taking place is equal (50%).

The Spinning Top

Three prominent parts of the Spinning Top are:

Small Real Body

Indicates that the open price and close price are quite close to each other. Because the open and close price points are nearby to one another, the color of the candle does not really matter.

The Upper Shadow

The upper shadow connects the real body to the high point of the day. If it is a red candle, the high and open are connected. If it is blue candle, the high and close are connected. The presence of the upper shadow tells us that the bulls did attempt to take the market higher. However they were not really successful in their endeavor.

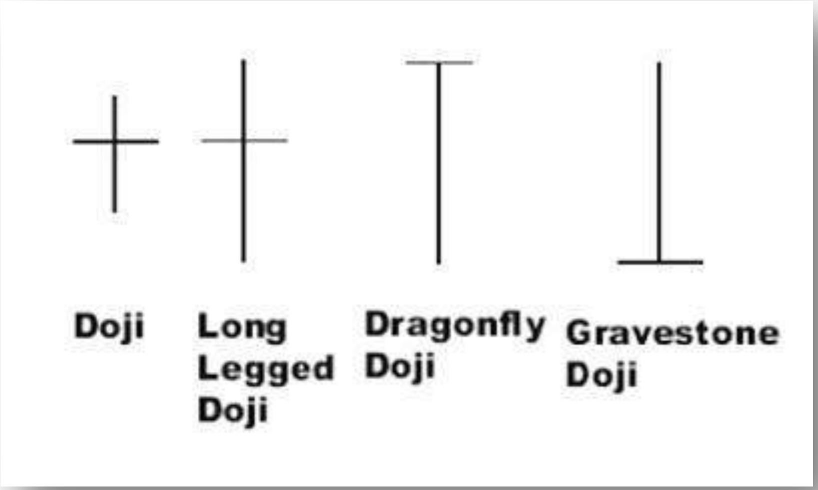
The Lower Shadow

The lower shadow connects the real body to the low point of the day. If it is a red candle, the low and close are connected. If it is a blue candle, the low and open are connected. The presence of the lower shadow tells us that the bears did attempt to take the market lower. However they were not really successful in their endeavor.

The Dojis

In a Doji both Open Price and Close price will be very close with virtually non existent real body. The colour of the candle is immaterial as the range is very narrow.

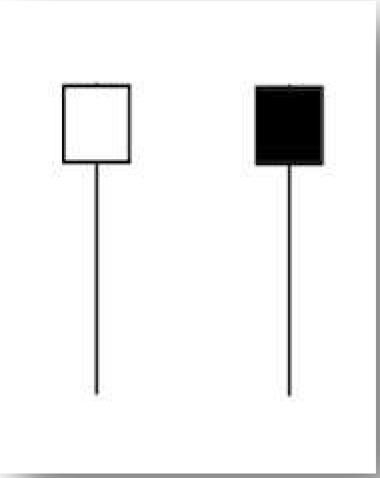
Doji's represents indecision in the market. Both the shadows can be of any length.



Paper Umbrella

The paper umbrella is a single candlestick pattern which helps traders in setting up directional trades. The interpretation of the paper umbrella changes based on where it appears on the chart.

- Hammer – Appear at the bottom end of the down trend.
- Hanging Man – Appear at the top end of the uptrend.
- To qualify a candle as a paper umbrella, the length of the lower shadow should be at least twice the length of the real body.

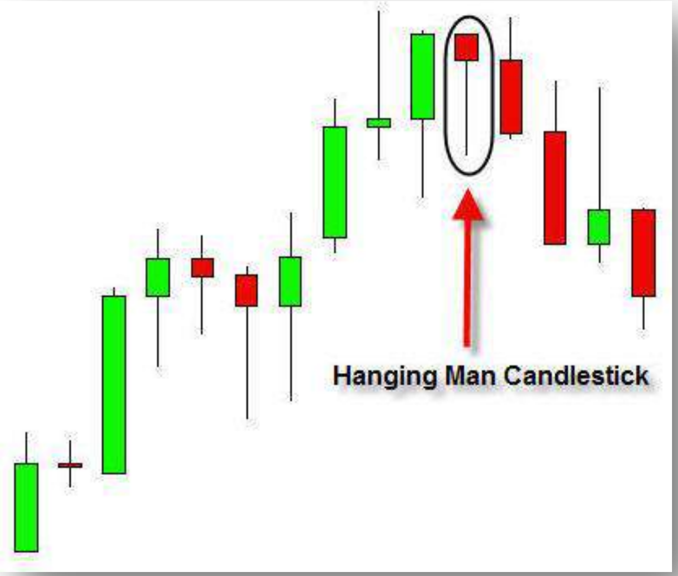


Bullish Hammer

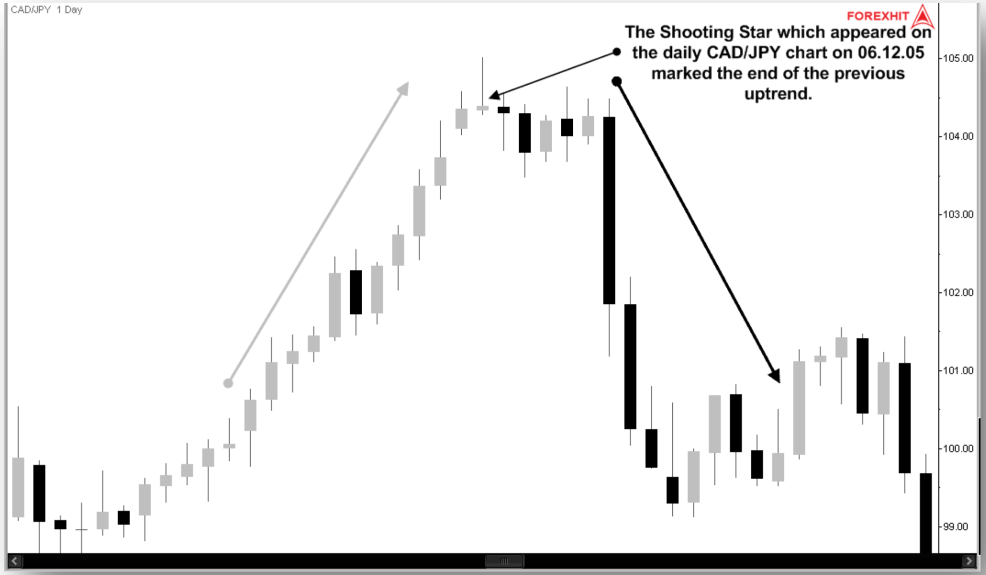
- Bullish Hammer Occurs at the bottom of a downtrend.
- The longer the lower shadow the more bullish the pattern.
- The prior trend for the hammer should be a down trend.
- A hammer formation suggests a long trade.
- The low of the hammer acts as the stoploss for the trade.

The Hanging Man

- Hanging Man Signals a market high and a trend reversal.
- Color of the candlestick is immaterial.
- The prior trend should be an uptrend.
- Market position should be exit or short sell.
- High of the candlestick works as the stop loss.



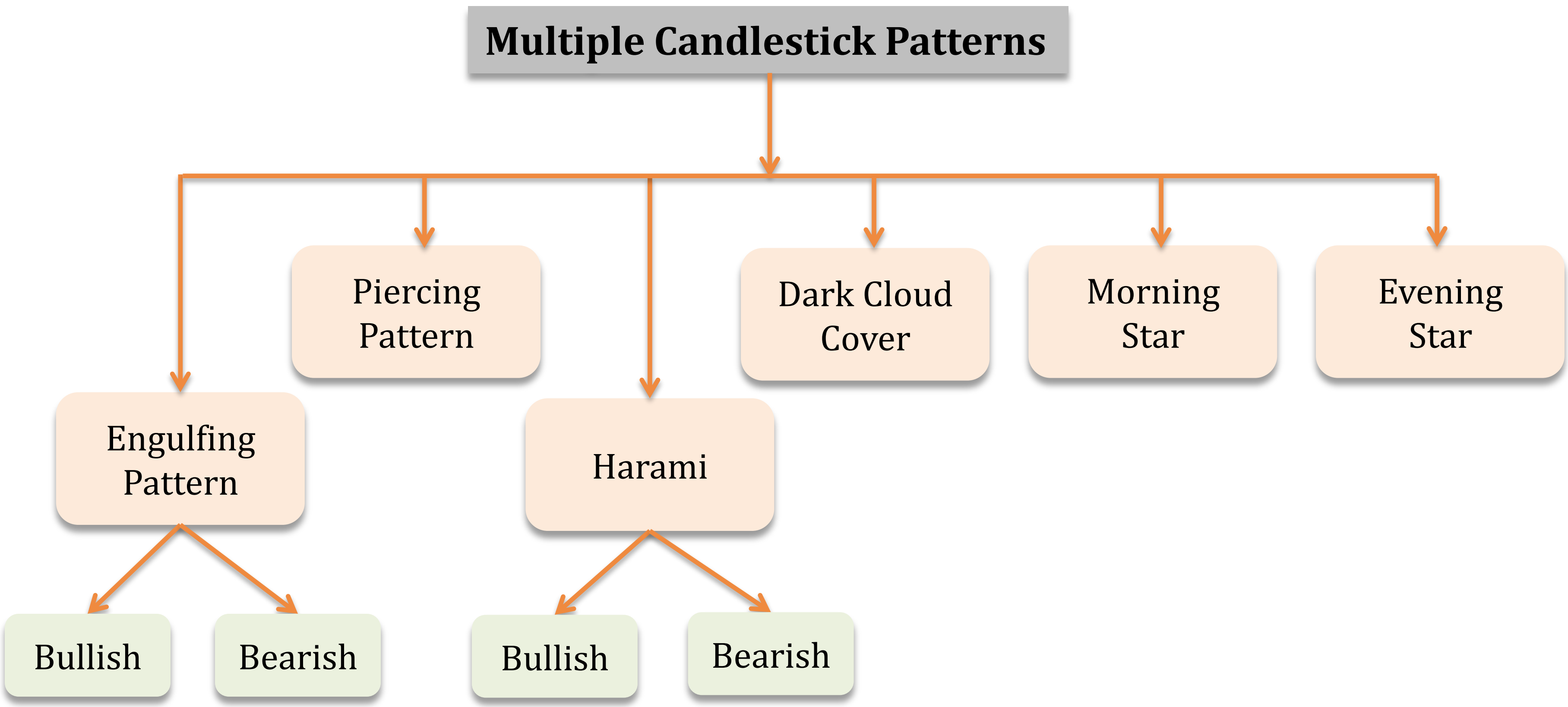
Shooting Star



- Unlike paper umbrella shooting star will not have a long lower shadow, instead it will have a long upper shadow.
- It signals a reversal of uptrend.
- Hence a red real body confirms the signal better
- Trade position is either exit or short sale.
- High of the upper shadow acts as the stop loss.

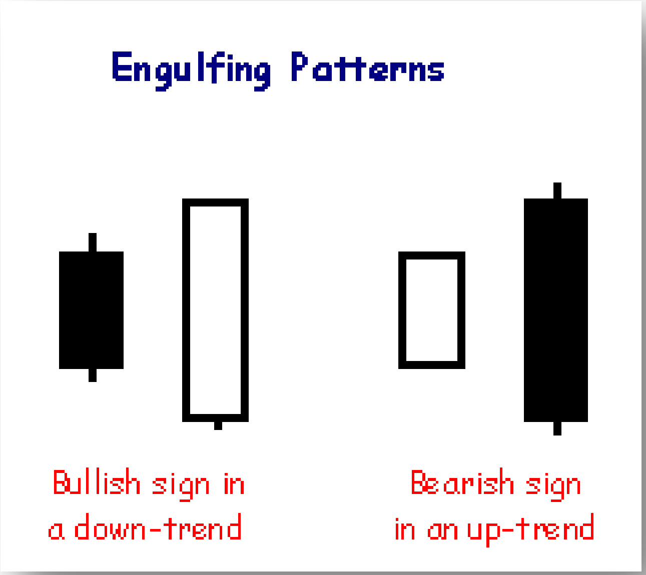
Multiple Candlestick Patterns

- In a multiple Candlestick pattern the trader needs 2 or more candlesticks to identify patterns.
- This means the trading opportunity evolves over a minimum of 2 trading sessions.



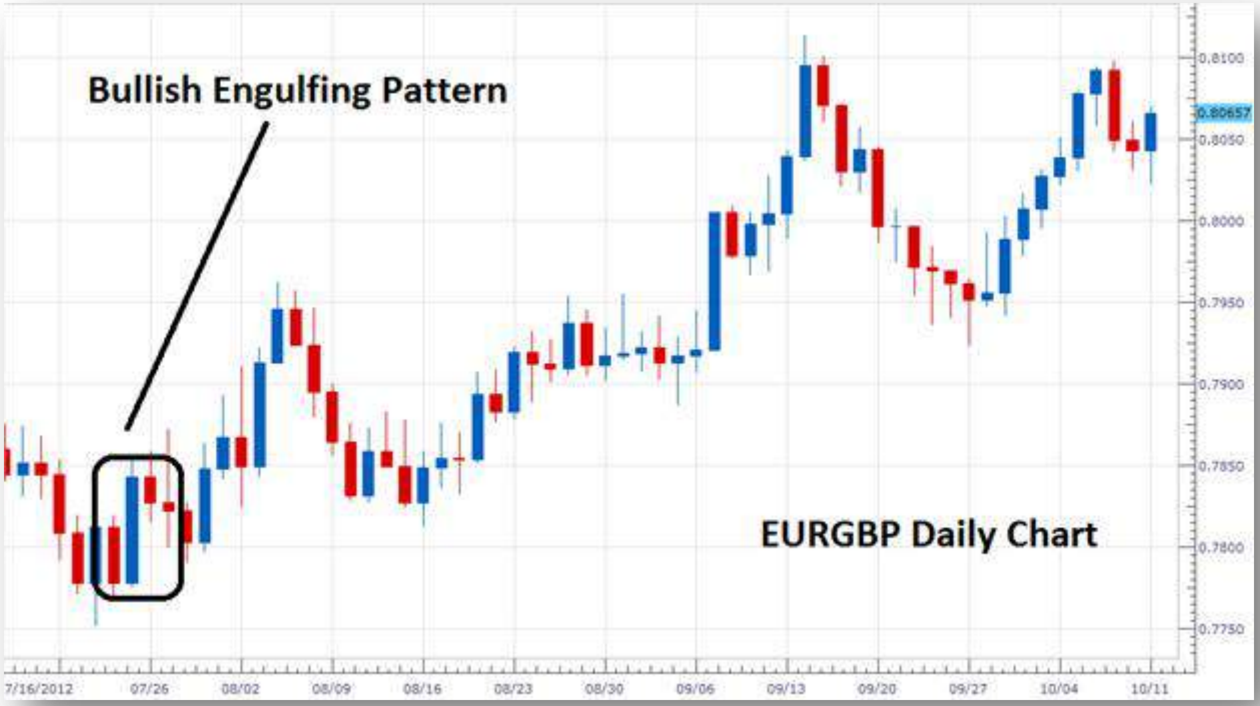
Engulfing Patterns

- The engulfing pattern needs 2 trading sessions to evolve.
- In a typical engulfing pattern there will be small candle on day 1 followed by a relatively long candle on day 2.
- If the engulfing pattern appears at the bottom of the trend, it is called the "Bullish Engulfing" pattern.
- If the engulfing pattern appears at the top end of the trend, it is called the "Bearish Engulfing" pattern.



The Bullish Engulfing Pattern

The bullish engulfing pattern is a two candlestick pattern which appears at the bottom of the down trend.



This is a bullish pattern which prompts the trader to go long.

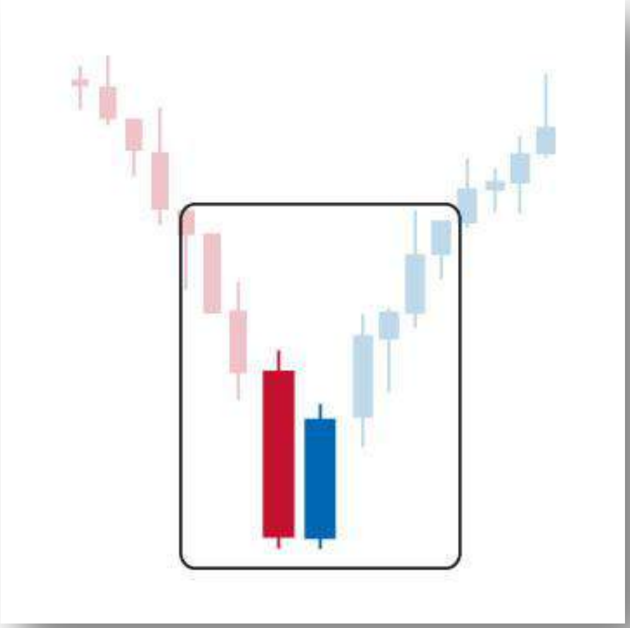
The Bullish Engulfing Pattern

- The prior trend should be a downtrend.
- The first day of the pattern should be a red candle confirming bearishness.
- Second day of the pattern should be a blue candle long enough to engulf the first candle.
- Buy price should be around the close price of blue candle.
- The stop loss for the trade would be at the lowest low between day 1 candle and day 2 candle.

The Bearish Engulfing Pattern

- The Bearish Engulfing Patterns forms on the top of an uptrend.
- Its bearish pattern, so trade position should be either exit or short sell.
- Sell price should be the close price of candle 2.
- Highest high of candle 1 and candle 2 acts as the stop loss for the trade.

The Piercing Pattern



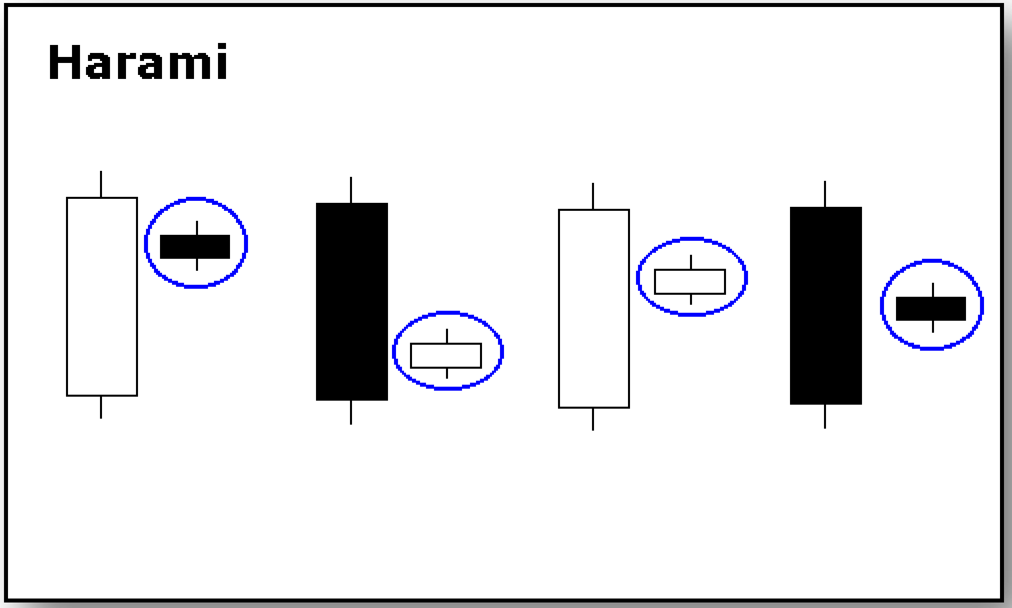
- In a Piercing Pattern red candle 1 partially engulf blue candle 2.
- However the engulfing should be between 50% and less than 100%.
- The Pattern appears at the bottom of a downtrend and signals a reversal.

The Dark Cloud Cover

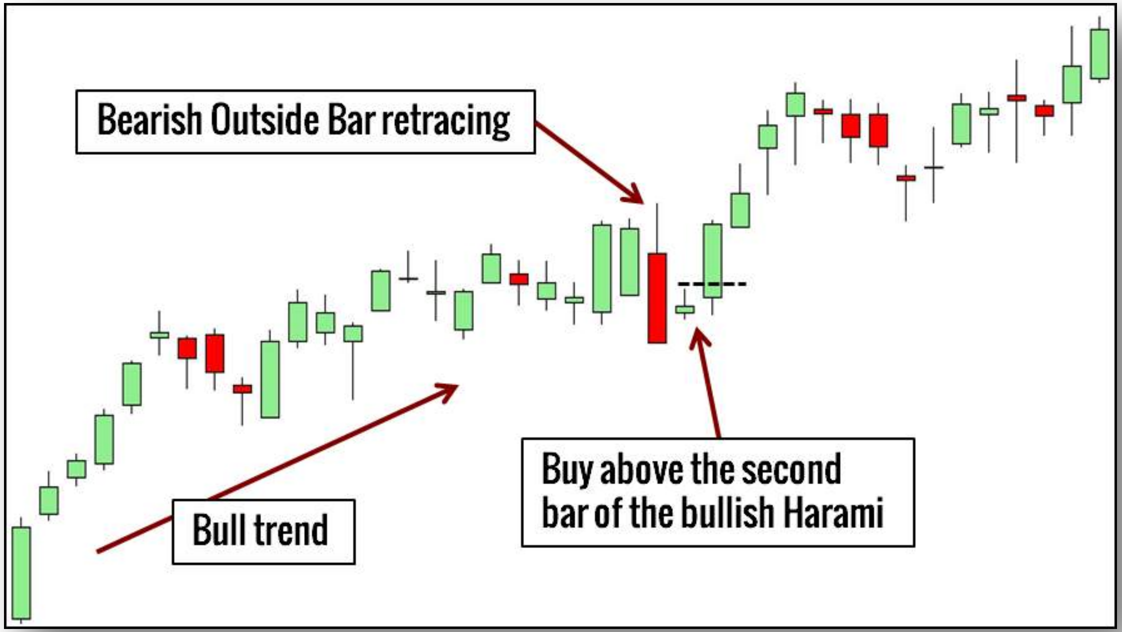
- Green candle 1 engulfs the red candle 2.
- Forms at the top end of an uptrend and signifies a trend reversal.

The Harami Pattern

- Harami in Japanese means “Pregnant”. It is a two candle pattern.
- The first candle is usually long and the second candle has a small body.
- The second candle is generally opposite in colour to the first candle.
- On the appearance of the Harami pattern a trend reversal is possible.
- There are two types of Harami patterns – the Bullish Harami and the Bearish Harami.

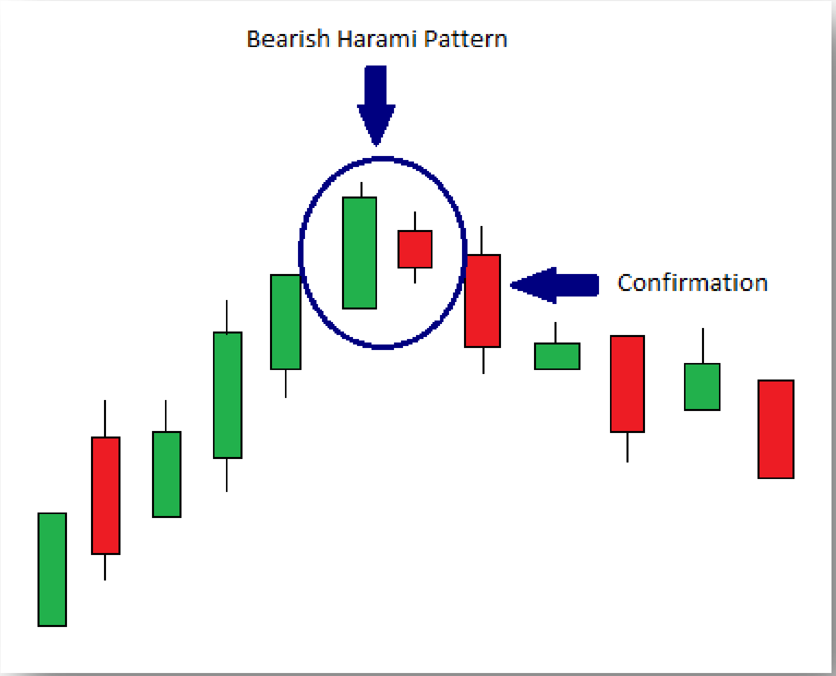


The Bullish Harami



- Bullish Harami is a bullish pattern appearing at the bottom end of the downtrend.
- Trade is initiated at the bottom close of the second candle.
- Lowest low of the pattern will be the stop loss for the trade.

The Bearish Harami

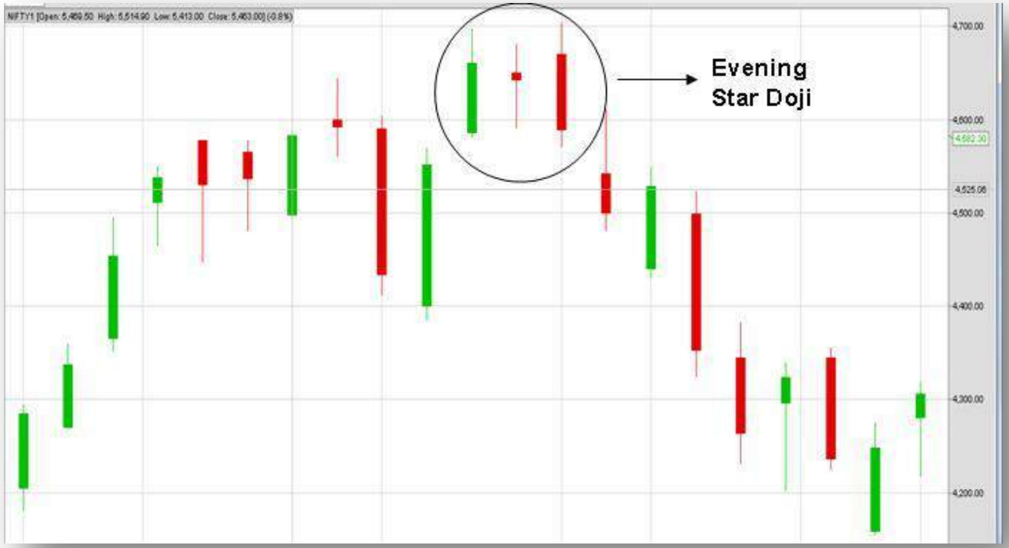


- The Bearish Harami pattern appears at the top end of an uptrend.
- It signals a trend reversal and can initiate a short sell.
- Short sell price can be the closing price on second candle.
- Highest high among the candles act as the stop loss.

The Morning Star

- The morning star is a bullish candlestick pattern which evolves over a three day period.
- It is a downtrend reversal pattern.
- First candle should be a red candle, second candle should be doji or a spinning top with a gap down opening, third candle should be a gap up opening with closing price higher than the opening price of first candle.
- Buy price would be the close price of 3rd candle.
- Lowest low in the pattern will act as stop loss.

The Evening Star



- The evening star appears at the top end of an uptrend.
- The evening star is a three candle formation.
- The first candle would be a green candle, the second candle would be a doji or spinning wheel., third candle would be a red candle with gap down opening.
- Initiate the short sell at the close price of the 3rd candle.
- Stop loss would be the highest high of the three cabdles.

The Moving Averages

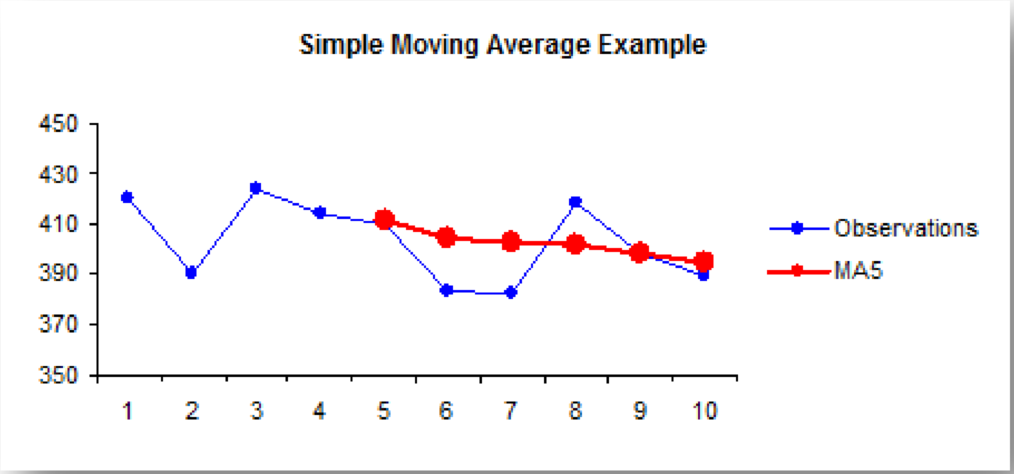
- A moving average is the average price of a security over a set amount of time.
- Averages removes the day to day fluctuations in trends and gives the trader clear directions of the trend.
- By using the averages the trader would be able to include more data to the analysis and ideal for identifying long term trends.

Most commonly used moving averages:

- Simple Moving Average
- Exponential Moving Average

Simple Moving Average (SMA)

- SMA simply takes the sum of all of the past closing prices over the time period and divides the result by the number of prices used in the calculation.
- Depending on the time period selected SMA uses the fresh set of data points to calculate the average and discard the first data point as and when the time progresses.



Simple Moving Average (SMA)

Cell Ref	Date	Close Price	5 Day Average	Average Formula
D3	1-Jan-14	1287.7		
D4	2-Jan-14	1279.25		
D5	3-Jan-14	1258.95		
D6	6-Jan-14	1249.7		
D7	7-Jan-14	1242.4		
D8	8-Jan-14	1268.75	1263.6	AVERAGE(D3:D7)
D9	9-Jan-14	1231.2	1259.81	AVERAGE(D4:D8)
D10	10-Jan-14	1201.75	1250.2	AVERAGE(D5:D9)
D11	13-Jan-14	1159.2	1238.76	AVERAGE(D6:D10)
D12	14-Jan-14	1157.25	1220.66	AVERAGE(D7:D11)
D13	15-Jan-14	1141.35	1203.63	AVERAGE(D8:D12)
D14	16-Jan-14	1152.5	1178.15	AVERAGE(D9:D13)
D15	17-Jan-14	1139.6	1162.41	AVERAGE(D10:D14)
D16	20-Jan-14	1140.6	1149.98	AVERAGE(D11:D15)
D17	21-Jan-14	1166.35	1146.26	AVERAGE(D12:D16)
D18	22-Jan-14	1165.4	1148.08	AVERAGE(D13:D17)
D19	23-Jan-14	1168.25	1152.89	AVERAGE(D14:D18

Simple Moving Average (SMA)

- Increasing the number of time periods in the calculation is the best way to measure the strength of the trend and reversals.
- The moving average changes as and when the closing price changes.
- The averages are then joined to form a smooth curving line known as the moving average line, and it continues to move as the time progresses.

Exponential Moving Average (EMA)

- EMA calculation uses a smoothing factor to place a higher weight on recent data points and is regarded as much more efficient than the linear weighted average.
- EMA is more responsive to new information relative to the simple moving average.

Cell Ref	Date	Close Price	5 Day Average	Average Formula
D3	1-Jan-14	1287.7		
D4	2-Jan-14	1279.25		
D5	3-Jan-14	1258.95		
D6	6-Jan-14	1249.7		
D7	7-Jan-14	1242.4		
D8	8-Jan-14	1268.75	1263.6	(D3*1+D4*2+D5*3+D6*4+D7*5)/15
D9	9-Jan-14	1231.2	1259.81	(D4*1+D5*2+D6*3+D7*4+D8*5)/15
D10	10-Jan-14	1201.75	1250.2	(D5*1+D6*2+D7*3+D8*4+D9*5)/15
D11	13-Jan-14	1159.2	1238.76	(D6*1+D7*2+D8*3+D9*4+D10*5)/15
D12	14-Jan-14	1157.25	1220.66	(D7*1+D8*2+D9*3+D10*4+D11*5)/15
D13	15-Jan-14	1141.35	1203.63	(D8*1+D9*2+D10*3+D11*4+D12*5)/15
D14	16-Jan-14	1152.5	1178.15	(D9*1+D10*2+D11*3+D12*4+D13*5)/15
D15	17-Jan-14	1139.6	1162.41	(D10*1+D11*2+D12*3+D13*4+D14*5)/15
D16	20-Jan-14	1140.6	1149.98	(D11*1+D12*2+D13*3+D14*4+D15*5)/15

Exponential Moving Average (EMA)

From the Graph its clear that EMA responds faster than SMA to price changes.

Applications of Moving Averages

Moving Averages are used for:

- **Identifying Trends**
- **Trend Reversals**
- **Set up Support Levels and Resistance Levels**

Applications of Moving Averages

Simple application of Moving Averages is to identify buying and selling opportunities.

When the stock price trades above its average price, it means the traders are willing to buy the stock at a price higher than its average price.

When the stock price trades below its average price, it means the traders are willing to sell the stock at a price lesser than its average price.

Applications of Moving Averages

Moving Averages can be used for developing a Trading System.

EXAMPLE

- Buy (go long) when the current market price turns greater than the 50 day EMA.
- Exit the long position (square off) when the current market price turns lesser than the 50 day EMA.

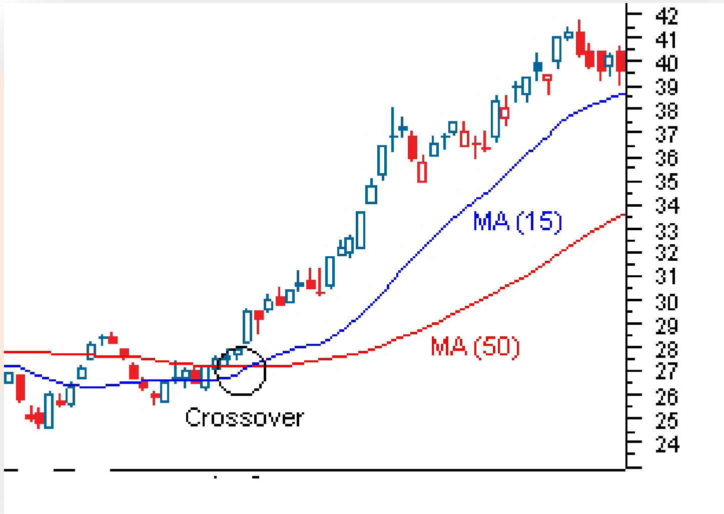
Moving Average Trend Reversal

- Moving Average Trend Reversals are formed in two ways:
  - When the price moves through a Moving Average.
  - When two moving averages moves through a crossover.

- Price of a security that was in an uptrend falls below a 50-period moving average is a sign of trend reversal.
- Trend Reverses once the price breaks below the 50 day SMA.

Moving Average Trend Reversal

The 15-day moving average crosses above the 50-day moving average, it is a positive sign that the price will start to increase.

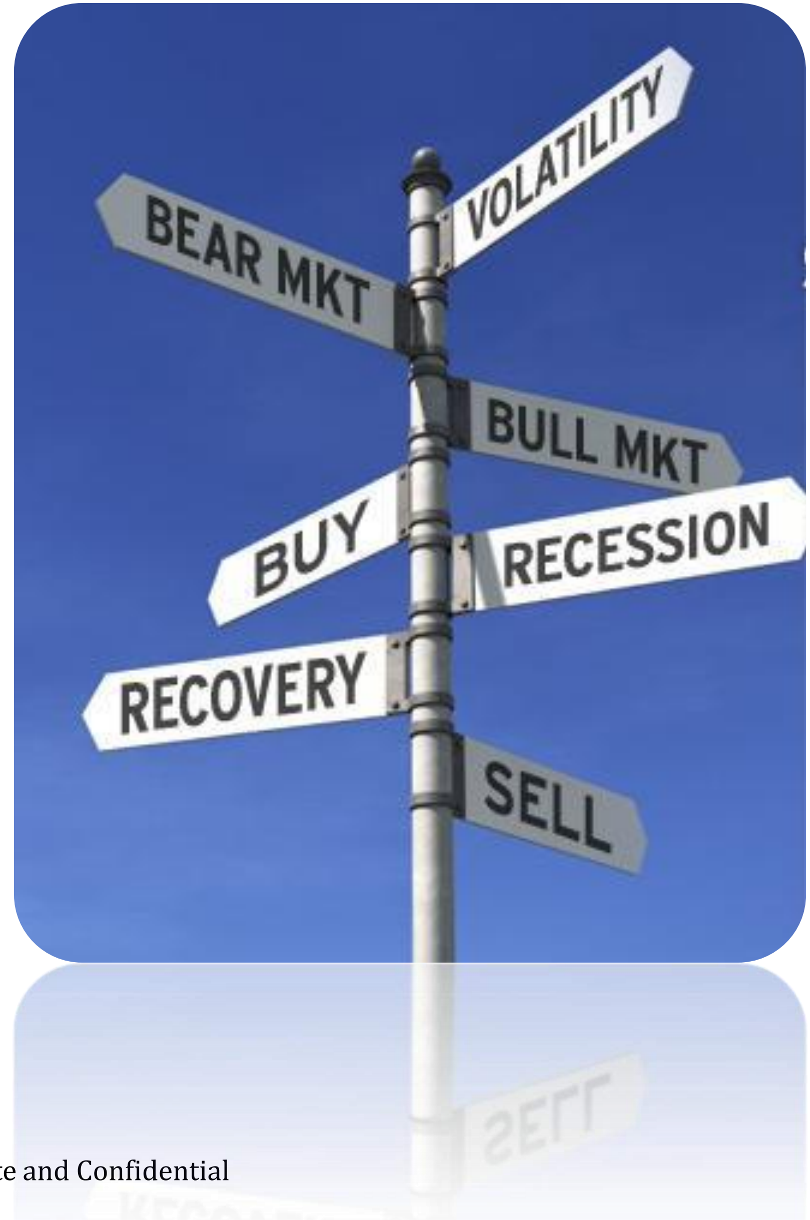


200 day Moving Average is used as a major support level.

Indicators and Oscillators

- Indicators are calculations based on the price and the volume of a security that measure money flow, trends, volatility and momentum.

- They are used as a secondary measure to the actual price movements and add additional information to the analysis of securities.



There are two main types of indicators:

Leading

A Leading indicator precedes price movements, giving them a predictive quality.

Lagging

A Lagging indicator is a confirmation tool because it follows price movement.

Indicators and Oscillators

There are also two types of indicator constructions: those that fall in a bounded range and those that do not.

Oscillator indicators have a range and signals periods where the securities are over bought or over sold.

Non-bounded indicators still form buy and sell signals along with displaying strength or weakness, but they vary in the way they do this.

Moving Averages Convergence Divergence

- Moving Averages Convergence Divergence or MACD comprised of two exponential moving averages, which help to measure momentum in the security.
- The MACD is simply the difference between these two moving averages plotted against a centerline.

FORMULA

MACD= shorter term moving average - longer term moving average

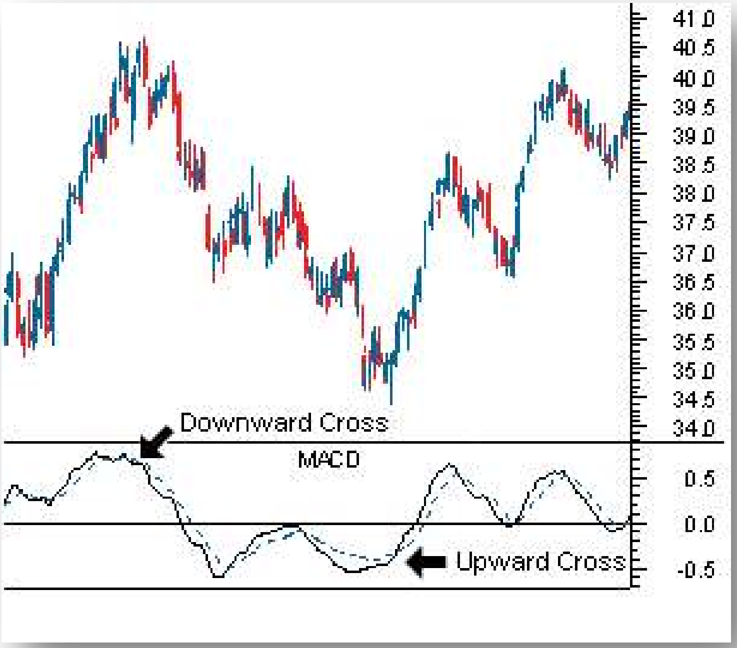
- The centerline is the point at which the two moving averages are equal.
- Along with the MACD and the centerline, an exponential moving average of the MACD itself is plotted on the chart.

Moving Averages Convergence Divergence

- The idea behind this momentum indicator is to measure short-term momentum compared to longer term momentum to help signal the current direction of momentum.

- When the MACD is positive, it signals that the shorter term moving average is above the longer term moving average and suggests upward momentum.

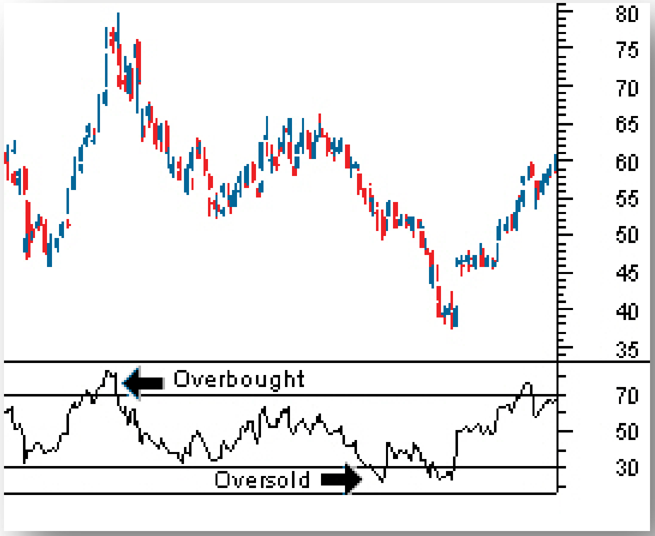
- When the MACD is negative - this signals that the shorter term is below the longer and suggest downward momentum.



Relative Strength Index

RSI helps to signal overbought and oversold conditions in a security.

- The indicator is plotted in a range between zero and 100.
- A reading above 70 is used to suggest that a security is overbought, while a reading below 30 is used to suggest that it is oversold.
- The standard calculation for RSI uses 14 trading days as the basis.
- If the trading period is adjusted to use fewer days, the RSI will be more volatile and will be used for shorter term trades.



Conclusion

- Technical Analysis is a method of evaluating securities based on historical data.
- Technical Analyst believes that all the information they need can be found in the Charts.
- Technical traders take a short-term approach to analyzing the market.
- Success of a Technical Call depends on number of followers, or the number of people following the same call on the same stock.
- It is a means to assess the psychology of the market for the short term.
- Technical Analysis is an art which can be perfected only through experience.
- Experienced Technical Analysts follows only two or three methodologies for their trading.

Corporate Actions

Corporate Actions

A corporate action is an event initiated by a public company that affects the securities issued by the company.

They are events agreed upon by the Board of Directors and authorised by the share holders.

Corporate Actions

Purpose of corporate actions are:

- Return profits to share holders
- Influence the share price
- Corporate restructuring

Corporate Actions

Corporate Actions are primarily classified as:

Mandatory	It is an event initiated by the corporation by the board of directors that affects all shareholders. Participation of shareholders is mandatory for these corporate actions. e.g.: Dividend
Voluntary	It is an action where the shareholders elect to participate in the action. A response is required by the corporation to process the action. e.g.: Tender or Open Offer
Mandatory with Choice	It is a mandatory corporate action where share holders are given a chance to choose among several options. e.g.: Cash or Stock Dividend

Dividend

Dividend is mandatory corporate action and a part of company's profit is distributed among the share holders.

In India, Dividends for many large companies are paid twice in a year.

Interim Dividend

Declared by the director, towards the halfway of financial year.

Final Dividend

Approved by the shareholders during the AGM and declared at the end of the financial year.

Dividend

Important Dates with respect to dividend are:

Declaration Date	The date on which dividend is declared by the board of directors and on which date dividend will be paid.
Record Date	This is the date on which company verifies its list of share holders to ascertain who will be paid the dividend.
Ex- Dividend Date	This is typically 3 business days prior to the record date. Stock purchased after this date will not be entitled to a dividend. Any transaction which is eligible to receive dividend post dividend declaration is called “cum dividend”, and any other transaction is called” ex-dividend”.
Payment Date	Date on which dividends are paid, and typically comes two weeks after the record date.

Arguments For and Against Dividends

For Dividend

- Dividends provide steady income for proverbial “widows and retirees”.
- Dividends are tax free in the hands of investors.
- Dividends provide certainty about the company's financial well-being.
- High Dividend Paying Companies are viewed positively by the Market.
- Investors would like to watch dividend yield, which is annual dividend divided by number of shares.

Against Dividend

- Dividends reduce companies’ retained earnings, and viewed as a sign that company does not have any future business expansion plans.
- For large dividends on the ex-dividend date, the stock price is adjusted downward by the amount of the dividend. The reason for the adjustment is that the amount no linger belongs to the company and affects its market valuation.
- Companies’ have to pay a dividend distribution tax of 16.995% (15% tax + 10% Surcharge + 3% educational cess).

Bonus/Scrip/Capitalization Issue

A bonus issue (also known as a scrip or capitalisation issue) is a corporate action when the company gives existing shareholders extra shares without them having to subscribe any further funds.

Bonus/Scrip/Capitalization Issue

The company will issue new shares to the existing share holders in proportion to their share holding.

Bonus issue increases the total number of shares issued and owned but does not change the value of the company.

In Bonus issue the ratio of number of shares held by each shareholder remains constant.

Shares	No of Shares	Share Price	Value
Before the bonus	1,000	200	200,000
Bonus Issue	250		
After the bonus	1,250	160	200,000

Bonus/Scrip/Capitalization Issue

EXAMPLE

XYZ plc's

Current share price
£12.00

The company decides to make a one-for-one bonus issue

An additional share on each share

A shareholder that held one share worth £12.00 now has two shares worth the same amount in total.

As the number of shares in issue has doubled, the share price halves to £6.00 each.

Stock Split

NUMBER OF SHARES OF PUBLIC COMPANY

PRICE PER SHARE

MARKET CAP

How Stock Splits Work?

BEFORE THE SPLIT

100 shares of stock → Priced at **Rs 50** each → Market Cap 100 × $50 = **$5000**

STOCK SPLIT AT 2:1

200 shares of stock → Priced at **Rs 25** each → Market Cap 100 × $50 = **$5000**

GOAL

Primary motive is to make shares seem more affordable to small investors.

Example of Stock Split

RANBAXY
LABORATORIES LIMITED

Pre-Split		Post-Split
22nd July, 2005	**2:1**	*25th July 2005*
Rs. 1039		Rs. 504

airtel

Pre-Split		Pre-Split
Stock Face Value		Stock Face Value
Rs. 10	**2:1**	Rs. 5
Market Price		Market Price
Rs. 800		Rs. 400

Reverse Stock Split

AKA
stock consolidation or
share rollback

NUMBER OF SHARES OF PUBLIC COMPANY

PRICE PER SHARE

MARKET CAP

Reverse Stock Split

- Does not add/ reduce any real value
- May come under renewed selling pressure
- May deter trading and short selling

BEFORE SPLIT:

10,000 shares at $0.5 Each

AFTER SPLIT:

5000 shares at $1 Each

The ratios associated with reverse splits are typically higher than those for forward splits like
1-for-10
1-for-50
1-for-100

Example of Reverse Stock Split

April 2011

$ 4.5

Many large investors don't prefer stocks trading below $ 4.

29 Billion → **2.9 Billion**

Important Dates in a Stock Split

SPLIT RECORD DATE:
Date on which the shareholders will be eligible for the split

SPLIT PAY DATE:
Date stock dividend or split will be paid

SPLIT EXECUTION DATE:
The first trading day following the "split pay date“

Rights Issues

A rights issue is an offer of new shares to the existing share holders on pro rata to their existing holding.

It is an option and not an obligation to the existing share holders.

Shares are offered at a discounted rate to the market price. In case of a rights issue the intention of the company is to raise additional capital.

Rights Issues

A requirement of the company law is that, if a company wants to raise capital, first the shares has to be offered to the existing share holders.

Existing share holders can transfer the rights to subscribe as these are renounceable and can be traded.

If a share holder is choosing not to subscribe during a rights issue, his ownership gets diluted post issue.

To ascertain the ex-rights share price, it is important to know the purpose of the additional funding.

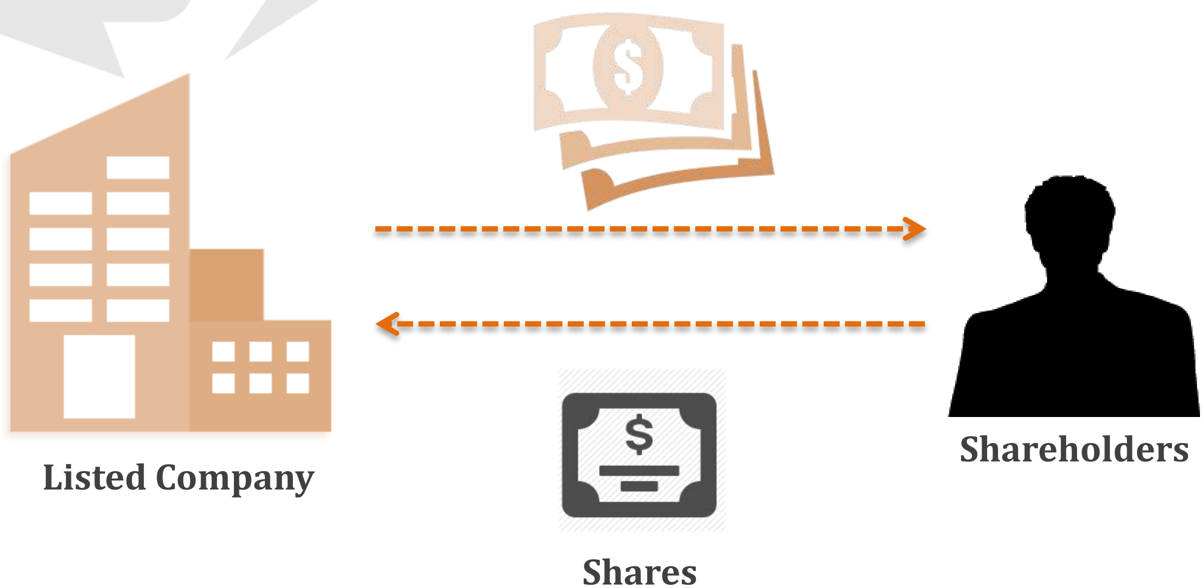
Buy Back

In buy back the issuing company repurchases the outstanding shares from the market.

Liquidity

Increase value of my shares by reducing the supply

Eliminate threats by shareholders looking for control



Buy Back

Increase the proportion of shares

Certain time frame and at a premium

Increase the value of shares or reduce the value?

Can buyback upto 10% of its paid up capital

Example of Buy Back

$14 billion

Takeover

Takeover is an inorganic growth strategy adopted by companies for its business expansion.

The acquiring company tries to acquire a controlling stake in the target company in exchange of cash or shares or a combination of both.

In a takeover, the acquired company cease to exist.

Merger

In a merger, two companies of similar size agree to merge their interest and function as one unit.

ABC Ltd.

Exchange interests and functions

XYZ Ltd.

- Corporate restructuring exercises are governed by Companies Act, Competition Act, and for listed companies it is also governed by SEBI Substantial Acquisitions and Shares Takeover Regulations.
- For Banks and Insurance companies guidelines issued by sector regulators are also applicable.

Q&A

Thank You For Your Attention